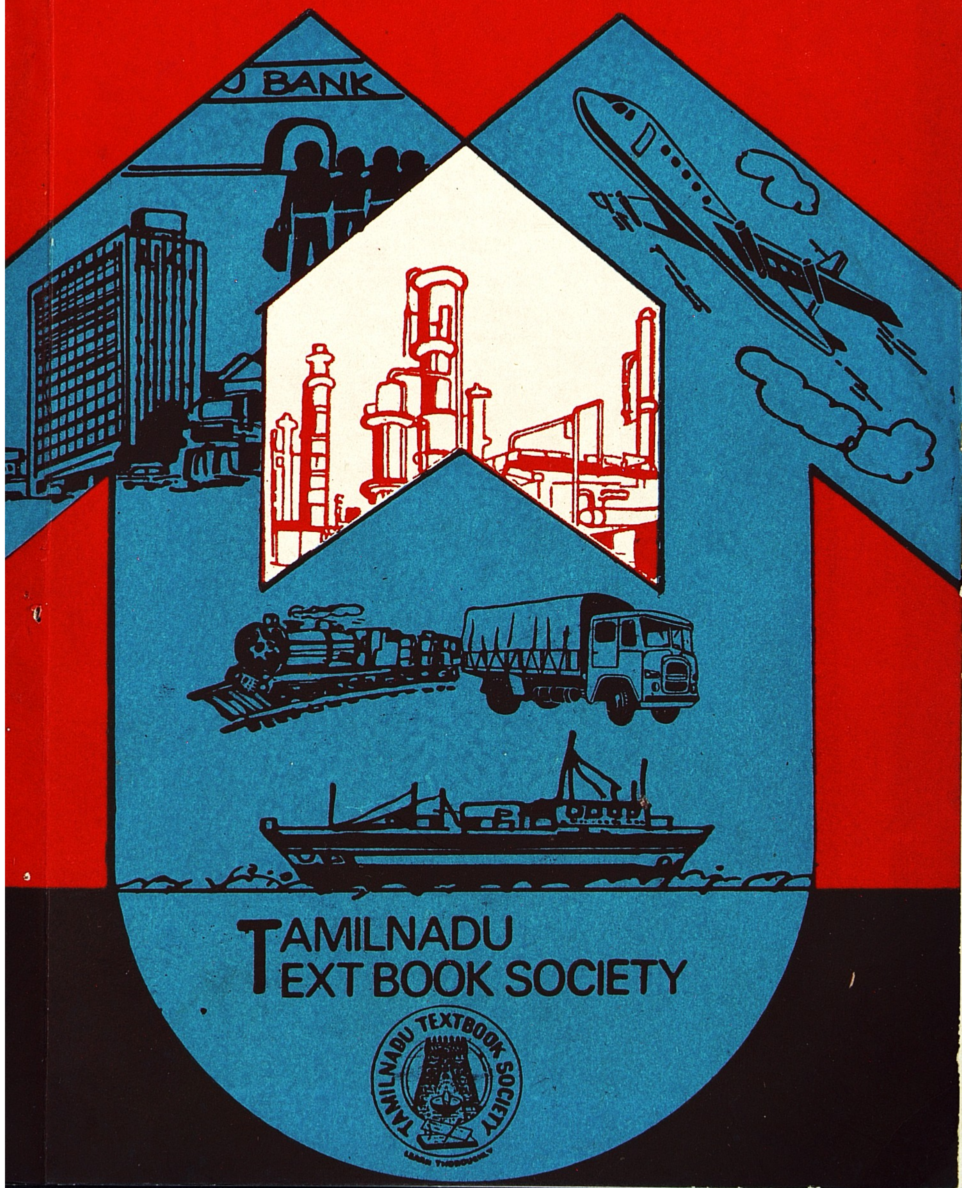
# COMMERCE

## HIGHER SECONDARY SECOND YEAR



# COMMERCE

## (Fundamentals of Business Organisation)

HIGHER SECONDARY - SECOND YEAR




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CHAPTER I

# ORGANISATION

**What is organisation?**

The pages of history are replete with instances of success crowning any good organisation. It is common knowledge that in military field, mere numerical strength cannot achieve success while a smaller force, if well organised, may win a war. It is organised recruiting and training of players, which wins laurels for the college hockey team. It is needless to say that a well organised business is poised for prosperity and growth. These examples vividly illustrate the advantages of organisation. It is obvious that whatever be the field of human activity, the need for organisation will be keenly felt.

The term 'organisation' is derived from the word 'organism' which means any system with parts dependent upon each other In a human body, it is the brain which controls, directs and co-ordinates the activities of different parts of the body. Similarly in Economics, it is the entreprenure (organiser) who brings together the other factors responsible for production. In a business, for the different functional activities such as producing, selling, financing, accounting, etc., there are different departments. If the goals of an enterprise are to be achieved, the activities of the different departments must be welded together. Organisation does this co-ordination work by establishing inter-relations between departments and thus ensuring the functioning of various departments as one undertaking.

**Definition**

Louis A. Allen has defined **Organisation** as "the process of identifying and grouping the work to be performed, defining and delegating responsibility and authority and establishing relationship for the purpose of enabling people to work most effectively

together in accomplishing objectives" From this, the following points emerge clearly.

(1) The purpose of an organisation is effective accomplishment of objectives. Whatever be the goal we have before us, we would like to achieve it with minimum effort. Organisation aims at the satisfactory fulfilment of the objectives of an enterprise.

(2) The first task of organisation is to find out the work to be performed. Having determined the activities of an enterprise, it should allocate them among different departments for efficient execution.

(3) Having allocated work, responsibility for performance of the work assigned must also be fixed. This calls forth granting of necessary authority—known as 'Delegation of Authority.'

(4) Since activities of an enterprise have been grouped, co-ordinating them to secure the fulfilment of the common objectives also becomes necessary.

Thus finding out the objectives, grouping the activities aimed at their achievement, assigning them for performance and co-ordinating them are the features of an organisation.

## PRINCIPLES OF ORGANISATION

### (1) Fixing of Objectives

In management terms, an **'Objective'** means a goal to be sought. The objectives of an enterprise must be clearly fixed. For example, it must be decided first what the enterprise wants to produce—whether one line of allied products or diversified products—whether quality goods or cheap ones—what rate of profit growth is to be achieved etc. Only when objectives are finalised, direction becomes clear and efforts may be made to achieve the goal.

**(2) Grouping of Activities**

This is known as 'Departmentation'. All the activities must be planned. This gives one an idea of the total workload of the enterprise. The various activities are to be grouped on some basis as mentioned below:

(i) *Functional Departmentation*: When an industry is organised into production, sales and finance departments, departmentation is said to have been effected on the basis of functions. All the activities of the same kind are placed under one manager. For example, Production Manager will be in charge of all manufacturing activities of the enterprise, no matter where plants are located.

(ii) *Departmentation by Product*: Under this method of departmentation, a manager placed in charge of a particular product will be responsible for all the activities such as manufacturing, sales, accounting, etc., relating to that product.

(iii) *Departmentation by Territory:* Under Geographic Departmentation, division is based on territories. This is resorted to when the needs of customers of the characteristics of the products can be best satisfied by territorial basis.

**(3) Activity to aim at achievement of goal**

It must never be forgotten that every activity of the concern — the effort of each must aim at and result in the fulfilment of the objectives set before the organisation.

**(4) Assignment of Activities**

The activities of an enterprise must be assigned to persons and groups. So many factors may guide the process of assignment.

(i) *Principle of Most Use:* It only means that if a particular department has most use for a particular activity, then that department should undertake it. For example,

if Production Department uses transport vehicles more frequently than other departments, the traffic functions can be assigned to Production Department. It must be understood that by assigning this acitivity to the Production Department, other departments are not prevented from availing themselves of the transportation service.

(ii) *Principle of Co-ordination:* The need for co-ordination can also be the basis for assignment of activity. For example, in a Departmental Store, the Departmental Manager is responsible both for the purchase and sale of the merchandise. These two different activities of buying and selling are assigned to the same executive because they must be co-ordinated. Otherwise, the executive in-charge of sales may attribute poor sales to improper purchasing and the executive in-charge of buying will hold poor salesmanship responsible for the lower turn over.

(iii) *Principle of Independent Check:* An activity which is to serve as a check on another activity must be assigned to different executives.

(iv) *Principle of Ease:* The ease with which an activity can be supervised effectively also determines assignment of work.

Activity may also be assigned on the basis of interest evinced by a particular executive.

**(5) Delegation of Authority**

In a large-sized undertaking, if authority is not delegated, unnecessary delay in decision making may lead to loss of rare opportunities. Frequent referring of small problems to higher authorities will take much of their valuable time, besides over-burdening their work. Hence the necessity of delegation.

When duty is assigned and responsibility fixed, necessary power to ensure performance of the task must also be given. For example, an executive is asked to promote sales. It means that he

has been assigned responsibility for sales promotion. He must be given powers to appoint salesmen, to advertise goods and in short, to do whatever he thinks best for boosting sales. Bereft of this necessary authority, his efforts to carry out the plan will only prove futile.

Once performance is entrusted to a subordinate, nothing should be done which will amount to unnecessary interference in the authority delegated.

**(6) The Principle of Responsibility**

When an executive delegates his responsibility and authority to his subordinate, the delegant does not divert himself of all the powers and he continues to be responsible for the acts of the delegatee.

**(7) Scalar Priniciple**

Line of Authority must proceed from the highest executive to the worker at the bottom level step by step through a downward flow. The superior has a direct authority over his immediate subordinate who is responsible for due performance of the task entrusted.

**(8) Unity of Command**

Every employee should have only one boss, for, a person cannot serve under two masters. If one is made answerable to many superiors, he will be confronted with the delicate problem of choosing a particular superior whose orders he should carry out first. In that process, he may have to displease others. The problem becomes all the more complicated, if the orders of the different superiors are conflicting in nature.

**(9) Span of Control**

Another principle of organisation is that there should be a reasonable Span of Control. Span of Control, also called Span of Management or Span of Supervision, refers in simple terms, to the number of subordinates a manager can effectively manage.

In other words, it means the number of subordinates directly reporting to an executive who is accountable for their performance.

Too small a number means creation of more levels and more departments. Apart from cost aspect, this would undermine the effectiveness of control. On the other hand, too large a number makes supervision ineffective. There are no hard and fast rules in this regard.

**(10) Co-ordination**

This denotes the orderly arrangement of group effort to provide unity of action. The individual actions of all in the organisation are to be co-ordinated so that the common objective of the enterprise may be realised. Further, different departments may also have to function frequently in close consultation with other departments. Co-ordination also means the making of arrangements for these smooth inter-departmental contacts.

**(11) Flexibility**

Organisation must be capable of realising the objectives even in the face of changing environments. It must permit of expansion or contraction without causing dislocation.

**(12) Simplicity**

Another principle of organisation is that it should be simple. Too many levels of authority, for example, complicate communication channels and by causing confusion and friction makes achievement of co-ordination impossible.

**(13) Efficiency**

Efficiency should be the watch-word of any organisation. If employees put forth their best, voluntarily and spontaneously, the firm will function with utmost efficiency. For this, they should have the necessary motivation and an atmosphere, in which cordiality instead of conflict, and friendship instead of friction prevail

## FORMS OF BUSINESS ORGANISATION

A vast multitude of establishments presently engaged in production and distribution of a wide variety of goods and services is of different forms. On the basis of ownership, the following are the main forms of organisations :

(i) Sole Trading Concern or Sole Proprietorship

(ii) Partnership

(iii) Joint Stock Company

(iv) Co-operative Societies and

(v) Public Undertakings.

### (1) SOLE PROPRIETORSHIP

**Sole Proprietorship** is a form of business organisation in which capital is contributed by only one person who uses his own experience and business acumen in the management of its affairs. He is called a **Sole Trader** or a **Sole Proprietor.** He may bring capital out of his own savings or out of borrowings from his friends and relatives. He may himself carry on the business, often assisted by the members of his own family. If it expands, he may get the assistance of paid employees. He sets up his shop usually by converting a portion of his residence for this purpose or he may take a rented portion.

Sole Proprietory Concern is the oldest form of business organisation. It is easy to form and easy to close. The Sole Trader, being the single investor of capital, reaps all the profits of his business; similarly he alone bears the entire risk.

The lure of getting the whole profit is an effective motivating force to put forth the best in him. At the same time the fear of loss and the resultant danger of losing his private assets to satisfy business debts make his steps measured ones. Always aware of demand position, he never allows his stock to accumulate dust. He is conscious of the fact that eternal vigilance is the price he has to pay for avoiding losses and increasing earnings. Ceaseless efforts and calculated steps are indeed his watchwords.

He himself manages the affairs of the business. He has to consult none. His decision is final; hence he can take prompt decision and benefit greatly by it. Delayed decision in any field of activity bears no fruit; in commercial world, it lands one in danger. In a Sole Trading Concern, the trader, being unanswerable to anybody, by taking timely decision, not only wards off grave and grievous consequences but also gains enormously.

The Sole Trader has absolute and unfettered freedom to act. He can even change his business line to suit changes in fashion. Nobody will question his authority. He is not haunted by a fear of challenge; he cannot be charged with by-passing anybody or any procedure nor can his action be held to be ultra vires his authority. This position enables him to introduce flexibility to his operations.

His personal contacts with his customers are close and cordial. By his courteous behaviour, he keeps his customers satisfied, for he knows pretty well that it is the satisfied customers who strengthen and build up his business rather than any attractive advertisement.

There is no place for conflict in his relationship with his employees. Even in the case of fairly large-sized Sole Proprietory concerns, cordiality and a spirit of comraderie prevail. This personal touch paves the way for continued success of the business units.

As against these favourable points, there is the other side of the picture which cannot be overlooked. Unlimited liability is always hanging like a 'Damocles's Sword' over the individual proprietor. That is, the law considers the individual and the business as one and the same person. Business is not regarded as an entity different from the proprietor who owns it. The result is that to satisfy the debts of the business, even his private properties become liable. His business creditors can stretch their hands beyond the assets available in the business.

The financial constraint, his inability to manage beyond a certain stage and the danger of unlimited liability impede

expansion. Hence Sole Trading concerns are as a result and as a rule, small-sized units.

## ADVANTAGES

### (1) Ease of Formation

Setting up a Sole Trading Business does not bristle with any difficulty. One may have to get a licence from local authorities for running certain types of business. But for this, no other legal formalities are to be gone through in this regard. Any person who has capital or the capacity to borrow and who has an aptitude for business can start it. Similarly, whenever he wants to wind up its affairs, he can do it with the same ease. He has just to find a buyer for it.

It is this factor more than anything else which is behind the springing up of countless petty shops every day throughout the world.

### (2) Personal Interest

The entire profits of the business go to swell his pocket; nobody else can claim a share in it. There is a direct relationship between effort and reward. The more he works, the more rewarded he will be. The desire to maximise his earnings supplies the necessary motivation for ceaseless efforts.

### (3) Threat of Loss

Just as profit acts as a great stimulant for hard work, so does the fear of loss. He alone has to bear all the losses. This fear of loss makes him very cautious in his approach and warns him not to slacken his efforts even for a while. He will always be vigilant, he will keep himself abreast of the market conditions; he never fails to notice any change of fashion and consequent change in demand position. Otherwise dead-stock will accumulate and loss will result.

### (4) Effective Control

He, being the only proprietor, has absolute control over all the activities of his business. He is the supreme judge of the situation. He has a thorough knowledge of all the aspects of his

business. Nothing will escape his eagle eyes. No wastages will be allowed; greater economy will be observed. Strict control exercised over the affairs of the business makes for a high degree of efficiency.

**(5) Quick Decision**

Promptness in taking decision is another advantage of individual proprietorship. We have already stated that he is the master of the situation; he need not wait for the approval of somebody else; he need not have even prior consultation with anybody before taking a decision. Whenever a favourable opportunity presents itself, he can immediately grab it and avail himself of all its benefits. For example, when he comes to know of an impending scarcity of a particular commodity, he can immediately arrange for its stockpile; similarly when he gets scent of a plethora of goods flooding the market and a consequent downward trend in its price in a few days he can resort to stock clearance and thus stave off a colossal loss.

**(6) Flexibility**

Whenever any change is called for in the style of functioning or in the nature of commodities dealt with, the Sole Trader can immediately effect it without fear of challange by anybody. This again is because he alone has to decide any issue. Thus this form of business organisation offers scope for flexibility.

**(7) Keeping of Business Secrets**

Secrecy of business affairs is a 'must' especially in the case of small business units. Individual proprietorship is the best suited in this respect. He is under no obligation to disclose to others whatever comes to his knowledge. In a competitive market maintenance of business secrets enables him to have an edge over his rivals in the field.

**(8) Close Contacts with Customers**

The Sole Trader knows his customers well and their tastes too. He is aware of their requirements and keeps stock of such

goods in his shop. Hence his customers, once they enter the shop, need not return disappointed. The Sole Trader's courteous welcome of his customers and his pleasing treatment earn for him their continued patronage. Even in the case of service units, the Sole Proprietor, by his skill and dexterity and by his suave manners and sweet temperaments, gives satisfaction to his customers.

**(9) Personal Contacts with Employees**

Since the business unit is a small-sized one, he has only a few employees in his concern and he knows every one of them personally. He understands their problems easily and solves them to their satisfaction. Absence of friction in their relationship brings about the success of his venture.

**(10) Credit Standing**

The liability of a Sole Trader is unlimited. Since apart from his business assets, even his private possessions are available for satisfying the claims of creditors, he can easily get financial accommodation. His credit standing is rated high.

**DEMERITS**

In spite of a number of advantages of a Sole Proprietorship, certain drawbacks are inherent in the form of organisation.

**(1) Small Capital**

The proprietor is the only person who provides the necessary capital initially and he has to make use of his own resources for his subsequent operations. It is obvious that a single man's resources will be insufficient to finance expansion.

Of course he can borrow from his friends, relatives and financial institutions. But there is a limit even to one's borrowing capacity. Besides this, interest payments will diminish his profits.

**(2) Limited Managerial Ability**

There is a limit to a person's ability to manage things efficiently. However intelligent and capable one may be in

handling the affairs of a business and however resourceful and wise a trader may be in taking quick decisions, his experience, expertise and business acumen will be less effective beyond a certain stage. With expansion in business, management become lax and cost of administration more. These trends will erode the profits.

**(3) Unlimited Liability**

As stated earlier, his trade creditors have a right to lay hands on his private properties also, if his business assets prove inadequate. Thus a Sole Proprietor, when he starts a business, risks not only his capital he has invested in the business but also his other properties, wholly unconnected with the affairs of his business.

These three factors, namely the limited resources, limitation to managerial process and the exposure of all the properties of the Sole Trader to the demon of unlimited liability act as a brake on the expansion of his business unit.

**(4) Short life of Business units**

Anything which affects the personal life of an individual proprietor affects his business too. Since the success of the venture mostly hinges on the personal qualities of the proprietor, any long illness or death brings the affairs of the business to a standstill. It can survive and continue to flourish, only if his successor also is a man of mettle and possesses requisite qualities of head and heart, which brought goodwill to the business earlier.

**(5) Absence of Specialisation**

The Sole Trader has himself to attend to all the aspects of his business such as managing, accounting, financing, advertising etc. A person who is expert in sales technique may be a poor accountant; another, good at figures may be inefficient in the art of managing. The size of the unit being small and resources meagre, it will be difficult to avail itself of the benefit of experts in different fields of business activities.

**(6) Hasty decision**

We have stated that a Sole Trader can take quick decision as he is not answerable to anybody. But sometimes the decision he takes in haste may spell ruin to the business. Decision, arrived at after deep deliberations and discussions, is sure to be better than that taken by one man. The wise counsels of other similarly experienced people are not available to a Sole Trader. While quick decision is an advantage, it may at times turn out to be a hasty decision which may prove disastrous ultimately. Does not haste make waste?

A single man has to decide on variegated matters. The staggering load of work does not allow him respite so essential for calm, cool thinking. Any wrong move may upset his calculations. Thus the fact, that he is under no obligation to consult others and get their consent, though an advantage in that it facilitates quick decision, is really a serious drawback.

It would appear from the above discussion that these serious limitations make a Sole Proprietorship an anachronism in the modern context of gigantism. It is true that very great advantages would flow from large scale operation and the Sole Trader form of organisation is not at all suitable for any big business enterprise. But that cannot minimise the importance and significance of an individual proprietorship. He may be a small fry; yet he is so indispensable even in the modern world that his absence from the field of exchange of goods is unthinkable.

It is the Sole Proprietor like lawyer, medical practitioner, technocrat, tailor, launderer who by his individual skill and experience renders essential service to the utmost satisfaction of his clientele and customers; it is the Sole Trader who makes available myriad items of daily consumption nearer our home and it is the Sole Trader who by adding personal touch makes buying a pleasing affair. Thus it is the most natural form of business organisation, which will stay for ever as it has stayed so long from times immemorial, whatever vicissitudes the process of exchange of goods may witness. To quote **Kimbal and**

**Kimbal**, "Of all the forms of Business Organisations, the Individual Proprietorship is the oldest, the simplest and and in some respects, the most natural".

Since we are going to deal at length other forms of Business Organisations under separate chapters, only a very brief description - a bird's eye view of them is attempted below.

## (2) PARTNERSHIP

We have already seen some of the defects inherent in the *organisation of Sole Proprietorship*. Of the drawbacks, the most important ones, which put spoke in the wheel of expansion, are financial constraints and laxity in management beyond a stage. They can be overcome to a large extent by associating a few more individuals in the ownership of the business unit. When the enterprise expands, responsibilities to be borne become too arduous for a single man that he thinks of sharing them with others. Thus a Sole Trader, who has found out that his business is already a paying proposition and that greater benefits are sure to flow, if it expands, may like to take into the business some more people who are closely known to him and in whom he has the fullest confidence. The business can now be called **Partnership**. What was originally started as an Individual Proprietorship has now been converted into Partnership. Partnership is not always brought into existence by this conversion method. A business unit can be straightaway set up on Partnership basis.

A minimum of two individuals is necessary to form a Partnership. "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all". It is now clear that Partnership springs from agreement. The number of persons is restricted to ten in the case of Partnership doing banking business and to twenty in the case of other busineses. First they must agree on certain essentials such as nature of business, amount of capital to be brought in by each partner, ratio in which profits and losses are to be shared, etc. The agreement can be oral. But it is always better to reduce it to writing so as to avoid

misunderstanding at a later date. The written agreement is variously described as Partnership Deed, Instrument of Partnership or Articles of Partnership.

A good deal of care must be displayed on the choice of partners as it rests on mutual trust and confidence. Once misunderstanding and mutual suspicion develop, the foundation of Partnership begins to crack. Each partner, by his lawful act in the course of the business, binds other partners and is similarly bound by the acts of others.

Every partner is entitled to manage the affairs of the business. Division of work is thus made possible with all its attendant advantages. we have seen that a Sole Trader has to attend to all the aspects of the business himself and the staggering load of work is beyond his capacity to bear. In Partnership, it is lightened, as responsibilities are shared. Each function can be assigned to one partner. For example, purchasing can be looked after by one partner and selling by another; accounting can be entrusted to one and the general routine to another. This functional division of work by facilitating concentration on allotted work ensures vigilance, so essential for the success of a business unit.

Decision on all matters is arrived at only after deep discussions among all partners. When partners put their heads together, the points are analysed from different angles and the final decision, thus, taken is sure to safeguard the interests of the concern. Sole Trader who has to depend on his own judgement and experience is denied of this benefit of collective action.

While a Partnership successfully overcomes some of the pitfalls of a Sole Trader, it retains certain others as mentioned below :

(i) The Partnership Act which governs the working of Partnership does not recognise Partnership as an entity separate from the partners constituting it.

(ii) The liability of a partner, like that of a Sole Trader, is unlimited. As stated earlier, while this exposes the

partners to serious risks, it is a blessing too. Raising of finance becomes easier, as lenders and creditors have large private assets of all partners to fall back upon even in the face of inadequacy of business assets at the time of dissolution.

(iii) Prompt decision is not feasible. Partners have to be consulted and unanimity of decision is required on all vital issues. But it must be admitted that, because of this, hasty step is always avoided.

With all these disadvantages, Partnership form of business organisation has come to stay. It is highly suitable for medium-sized business operations where one individual cannot meet the entire financial requirements or where one proprietor cannot devote his undivided attention to various functional divisions.

### (3) JOINT STOCK COMPANY

The limitation placed on the maximum number of partners in a Partnership firm renders collection of huge amount of capital impossible.

While modern civilisation has led to the multiplication of human wants. Industrial Revolution and the innumerable innovations in the productive processes have led to large scale production and faster exchange of goods, which required very huge capital outlay. Joint Stock Company form of organisation proved the only answer to the whole problem. It has got over many of the debilitating features of Sole Proprietorship and Partnership which hamper the formation of large industrial enterprises.

In general, **Company** is an association of persons for profit brought into existence by law with the special features of corporate personality and perpetual succession. That is, it is formed by only observing all the formalities prescribed by law (The Companies Act in India). It is regarded as an artificial person—a person seperate and different from the members composing it. This distinguishes a company from other forms of organisation. Both Individual Proprietorship and Partnership do not enjoy a separate existence.

The liability of a member of a Company is limited. There is, therefore, no danger of his being deprived of his private properties.

We have noted that anything which affects the personal life of a Sole Trader or a Partner affects the business of the proprietor or of the firm also. But a Joint Stock Company, being a separate juridical person, continues to carry on its affairs unaffected by death, insolvency or insanity of its members. Thus this feature of permanence known as perpetual succession is an advantage of great significance. If big industrial enterprises have to close up business by these happenings, problems of unimaginable enormity and gravity will follow.

Very huge capital required for setting up large sized commercial and industrial units can be mobilised by a Joint Stock Company.

Capital is divided into shares of a fixed amount. These shares are transferable. Thus separate legal entity, limited liability, perpetuity, facility of transfer of shares are all the attractive characteristics of a joint stock form of organisation. But it has its own pitfalls. The legal procedures laid down by law for its formation are considerably complex, cumbersome and costly.

It has to scrupulously follow at every step the provisions of the Act, the infringement of which will entail visitation of heavy penalties. Shareholders who are the real owners do not have the right to manage the affairs individually. Management is entrusted to a Board of Directors, elected by the shareholders themselves. There is separation of ownership from management.

Quick decision is not possible. It is not suitable for such types of business as are susceptible to changes in fashion. Inflexibility is an element inherent in a joint stock form of business organisation.

With all these disadvantages, Company form is the only organisation, suited for large scale operations.

## (4) CO-OPERATIVES

The modern factory system, an offshoot of Industrial Revolution brought in its train exploitation of labourers with a view to earning excessive profits. The innumerable difficulties and economic hardships to which the labouring class and other weaker sections of society were subjected called forth joint action on their part for mutual help. Co-operative ideas caught the imagination of social thinkers and reformers like **Robert Owen** who spread the message and set up a number of stores. It was given to **Rochdale Pioneers** who launched the modern co-operative movement in England. Thereupon co-operative movement began to make its headway in various countries of the world and it took various forms in different countries depending upon local conditions.

Whatever forms or shapes co-operative movement takes, the underlying principles are more or less same. They boil down to this:

(i) The economically weak should be freed from the moneyed class,

(ii) If those who have common economic problems associate together and make common endeavours, a satisfactory solution is possible.

"It is an association of the weak who gather for a common economic need and try to lift themselves from weakness into strength through business organisation".

**A Co-operative Society** can be defined as, "a voluntary association of persons who have some common economic problems for the solution of which they make joint efforts." For example, handloom weavers can join together to promote their interests through joint endeavours. Consumers can associate together and set up stores which can supply their requirements at fair price. Thus we find the **commonness of economic interest** running through all these societies.

It is a voluntary association. The fear of exploitation and a determination to resist it and remove it by collective action impel persons to associate together. No other force compels them to do so.

It has as its aim the solution of their economic problems and satisfaction of their needs. For example, the object of a Students' Co-operative Stores is the supply of books, notebooks and other stationery required by them at fair price. Though co-operatives also aim at earning profit so that they may keep their heads above water, profiteering which fleeces the poor and the weak is never resorted to. Service, rather than profit, is its guiding principle. This distinguishes a co-operative from other forms of business organisations, the sole motive of which all is profit and nothing but profit.

Membership is open to all irrespective of caste, creed, political leanings or any other consideration. The nominal value of a share is also very low and this enables even those at the economic bottom of the society to acquire membership of the co-operative society and gain by it. It is a democratic organisation. Though its management is entrusted to a Board of Directors known as the Management Committee, members take keen interest in the affairs of the Society. Strict adherence to the principle of '**One member, One vote**' gives equality of opportunity to both the poor and the opulent alike. Directorship of a Co-operative Society is not the preserve of the privileged sections of the society. This contrasts well with a Joint Stock Company where the principle **One-share One vote** enables only the moneyed class to dominate the management scene.

The entire earnings of a Co-operative Society are not distributed as 'Dividend'. Further, Bonus based on Purchases is also given to members. That is the extent to which a member has used the society determines the amount of his bonus.

All these characteristics make a Co-operative form of Business Organisation entirely a different one. Shares are not transferable. But withdrawal of membership is permitted. Liability is usually limited. Various kinds of Co-operatives are formed to cater to the different needs of persons. Though Industrial Co-operatives are also set up, they are not suitable for any large scale operation.

All these virtues are not realised in practice. Members, because of their ignorance and illiteracy, are totally indifferent

to the working of the Societies. Grave irregularities, misappropriation of funds and nepotism are all rife. Even in Co-operative societies, money bags gain control and develop vested interests. The poor uneducated members, unconscious of their might, are only silent spectators of these goings on! In India, Co-operatives are Government-sponsored and Government-controlled. Officialdom holds sway over their entire activities.

## (5) PUBLIC ENTERPRISES

The days of non-intervention by the State in the economic life of a nation have gone in most countries of the world. Government of the present day in any country especially one which believes in and works for a socialistic society plays not only an active role in the improvement of its economy but promotes its economic development along particular directions. Thus State, not merely controls in an increasing measure the working of industrial enterprises, but owns industries in certain specified fields. While a detailed discussion of the Public Undertakings and of the various modes of Government organisations is given in a separate chapter, let us see here the salient features of Public Enterprises.

Public Enterprises or Public Undertakings are industrial concerns owned and managed by Government. While in some cases, participation by private investors in the ownership capital of such enterprises is allowed, a major shareholding is in the hands of the Government. Thus it retains its controlling influence over their management. Government may acquire ownership of industries either by nationalising existing units or by floating afresh new enterprises.

Since the ownership vests with the Government, the profits earned by these units go to augment the revenues of the Government. Government can make use of the newly generated resources for further development and for implementing various schemes to better the lot of the common man.

When the Government uses the resources for further industrial development, more employment opportunites are created thus solving the ever mounting unemployment problem,

The avowed object of Government undertakings is rendering of service. They also, without doubt, aim at profit—but that is because they have to sustain their existence and survive without continuous Government prop. What is stressed here is the fact that earning of excessive profit is not the goal of any Public Enterprise.

Public interest is never sacrificed. It is given the utmost importance. Even lopsided development of various regions is set right by starting industries in economically backward areas.

In the case of Joint Stock Companies, the profit earned fattens the purse of private people, thus widening the gulf between 'the haves' and 'the have-nots.' But Government undertakings try to bridge disparities in income distribution and prevent concentration of economic power in a few hands. Certain strategic sectors like Defence Industries are always owned by Government in the interests of national security.

Private investors may also be reluctant to set up industries which take a long period for reaching profit earning stage. Government has to come forward and establish industries of this type also. A discussion of the above points reveals that certain industries either because of long gestation period or because of strategic importance are to be owned and managed by Government alone.

Like any other business organisation, State Enterprises also have certain drawbacks. The first and the foremost among them is the lack of personal interest in the affairs of this concern which feature is responsible for all-round inefficiency. Employees are unenthusiastic and not properly motivated. No deterrent punishment visits even serious lapses.

Absence of proprietory interest on the part of those occupying the top echelons of administration is responsible for this state of affairs.

State Enterprises can neither take advantage of any changed conditions nor can they change themselves to new situations. Red-tapism, the bane of bureaucracy obstructs quick decision and kills efficiency.

## QUESTIONS

### Multiple Choice Type

I. Choose the correct answer

1. For large-sized industrial undertakings, the form of organisation best suited is

   (a) Partnership.

   (b) Joint Stock Company.

   (c) Co-operatives. (b)

2. The benefit of discussion and collective judgement is absent in

   (a) Sole Proprietory Concern.

   (b) Partnership.

   (c) Joint Stock Company. (a)

3. Control and ownership go together in

   (a) Individual Proprietorship.

   (b) Joint Stock Company.

   (c) Co-operative Society. (a)

4. A Sole Proprietory Concern

   (a) is free from legal requirements.

   (b) enjoys separate existence.

   (c) must be compulsorily registered. (a)

5. In a Co-operative Society,

   (a) 'One share, One vote' principle is followed.

   (b) 'One man, One vote' principle is followed.

   (c) Shares are transferable. (b)

**II. Fill in the blanks with a suitable word or words**

6. The process of identifying and grouping the work to be performed and establishing authority relationships is known as..............

(Organisation)

7. Business secrets can be preserved effectively in............ form of Business Organisation.

(Sole Proprietory)

8. The liability of a partner in a Partnership firm is.........

(Unlimited)

9. The form of organisation which lends itself most to flexibility is................

(Sole Proprietory Concern)

**III. State whether the following statements are 'True' or 'False'**

10. Unity of Command means that order given by all superiors must be same.

(False; every employee should have only one superior)

11. When a responsibility is entrusted to a subordinate, necessary power for due performance must be given.

(True)

12. Every employee should have only one boss.

(True)

13. In an Individual Proprietorship, capital is contributed by a minimum of two persons.

(False ; by only one)

14. The liability of a Sole Trader is limited.

(False; Unlimited)

15. 'Limited Liability' means that the liability of a trader is a small sum.

(False ; liability is limited to business assets)

16. Creditors hesitate to lend if the liability of the owners of business is unlimited.

(False ; ready to lend)

17. One, who inclines to control the business he owns, can invest in Corporate Form of business organisation.

(False ; Sole Trader or Partnership)

18. From the point of view of continued existence, Partnership is the most suitable form of Business Organisation.

(False ; Joint Stock Company)

19. Unlimited liability stimulates hard work.

(True)

20. State Enterprise means an industrial undertaking established with State Capital.

(False ; an industrial undertaking owned by Government)

## IV. Match the following

| | | | |
|---|---|---|---|
| 21. | Departmentation | a. | Chain Store |
| 22. | Joint Stock Company | b. | Grouping of activities |
| 23. | Co-operative Society | c. | Separate existence |
| 24. | Sole Trader | d. | Dividend based on purchase |
| 25. | Public undertaking | e. | Absence of the benefit of collective judgement |
| | | f. | Government ownership. |

[ 21: b; 22: c; 23: d; 24: e; 25: f ]

## V. Medium Type Questions

(Answer should not exceed one page)

26. Explain the term, 'Organisation'.

27. Explain the terms 'Limited Liability' and 'Unlimited Liability'.

28. What are the demerits of a Sole Trading Concern?

29. Enumerate the chief defects of a Joint Stock Company.

30. What defects of Sole Proprietory Concern are removed by Partnership?

31. Are 'freedom to act' and 'quick decision' always beneficial to a Sole Trader?

## VI. Essay Type Questions

(Answers should not exceed three pages of normal handwriting)

32. Explain briefly the principles of Organisation.

33. What are the merits and demerits of an Individual Proprietorship?

34. Does Partnership remove all the defects of Sole Proprietorship?

35. In what respects is Partnership superior to Individual Proprietorship?

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CHAPTER II

# PARTNERSHIP BUSINESS

Partnership, the second form of Business Organisation, was evolved to overcome the limitations of Sole Proprietorship.

## SHORTCOMINGS OF SOLE TRADER BUSINESS

(1) **Limited Finance**: A single person, however rich, cannot provide all the capital needed for expanding business His capacity to borrow is also limited by the extent of his private property.

(2) **Absence of Risk-sharing**: Business expansion entails greater risk of loss. A Sole Trader "owns all and risks all." A single person does not have the capacity to bear alone the larger risks of expanding of new ventures. He cannot share his risks with another person. So ventures, very profitable, cannot be started for fear of the greater risk.

(3) **Limited Managerial Ability**: Success in business expansion calls for use of variety of talents to the maximum extent. Even the most skilled and experienced trader cannot be expected to possess, in a high degree, all the types of talent needed for this purpose. Paid managers can be employed but will not evince that keen interest which the owner will show.

(4) **No Division of Labour**: Sole Trader, being the only man, must look into all aspects of his business. He cannot have specialisation of functions. Business diversification and expansion are hampered.

Partnership business overcomes all the above deficiencies of Sole Tradership and bring about dynamic growth of business in varied fields. Partnership may be formed by a Sole Trader keen

on expansion of business, taking in his most experienced employee as a partner. Or a rich man with lot of investible funds but no business experience or talents can combine with a man of much business acumen but no money. Thus a marriage of money and managerial talents can take place for furtherance of business and industry.

## DEFINITION OF PARTNERSHIP

According to the Indian Partnership Act, 1932 (Sec. 4) **Partnership** is "the relationship between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

Each member is called a 'Partner' and all the persons are collectively called a 'Firm'. The name under which the business is done is called 'Firm Name.'

### Legal Features

The above definitions clearly bring out the following legal characteristics of a Partnership :-

(1) **Multiplicity of Persons** : Partnership is the relationship between persons. So there must be more than one person. The minimum number of persons is two. The maximum number of persons in a Partnership is not fixed by the Partnership Act. But the Indian Companies Act, 1956 which regulates Joint Stock Companies has stated that Partnerships with more than 10 persons in Banking and with more than 20 persons in any other business are illegal. So, the maximum membership can be taken as 10 for Banking Partnership and 20 in any other business.

(2) **Created by Agreement :** Partnership is created only by an agreement among the persons. It is not the result of birth or status. The agreement can be in writing or oral or inferred from conduct of parties, but a written agreement is the best safeguared against future disputes among the partners. Suppose, A & B join together and buy and sell goods sharing the profits or losses, a Partnership can be inferred from their behaviour. Since Partnership is arising from agreement, only

persons, legally capable of making an agreement, can become partners. E.g., a lunatic, a minor or an undischarged insolvent cannot become a partner.

(3) **Sharing Profits**: The agreement must be to share the profits. Sharing profits generally implies sharing losses also. But sometimes the partners may agree that a particular partner need not share any loss. No partner will agree to share only losses. The profits and losses can be shared in the same way or in different proportions. But where no ratio is agreed upon, profits and losses must be shared only equally and not in the ratio of capitals. But it must be remembered that profit sharing is only *prima facie* evidence of Partnership and not the conclusive test.

(4) **Existence of Business**: The profits or losses to be shared must have some source. This source is some business. Business means any trade, occupation or profession. E.g., Tailoring business, Partnership of lawyers. But the business must be legal i.e., not against any law in force in the country. In Tamil Nadu, a Partnership to deal in liquor is not possible now. Similarly a Partnership to smuggle goods is illegal. Again persons carrying on charitable works commonly are not partners because their work is not to earn any profit.

(5) **Business to be carried on by All or Any of them acting for All**: All the partners must carry on the business i.e., every partner has equal right to participate in business. But for practical reasons, the partners may agree that only one or a few partners will manage the business. Then such partner or partners entrusted with business management must do so for the mutual benefit of all the partners. Partnership is, therefore, described as an extension of the 'Principle of Agency'. Carrying on business in common or one partner or partners acting for all partners is the real test of Partnership. In a business, a creditor may receive a share of annual profits in lieu of interest or a manager may be given a share of profits. The creditor or the manager is not a partner, though he shares in the profit; because the business is not done by or on behalf of the creditor or the manager.

**Other Legal Characteristics**: Certain other features not mentioned in the above definitions can also be stated.

(1) **Unlimited Liability**: Every partner has unlimited liability for business debts. If the assets of the partnership are not enough to repay all the business debts in full, the private property of the partners can be used for such purpose. Therefore, a partner's liability for business debts is not restricted to his capital contribution. This unlimited liability of a partner is also joint and several. The business creditors can claim satisfaction from the private properties of all the partners taken together (Joint liability); or they can take action against the private assets of any one partner to get their money (Several liability).

An example will make this clear. 'A' & 'B' are partners with business assets Rs. 10,000/- and business liabilities Rs. 17,000/-. The unsatisfied business creditors for Rs. 7,000/- can recover their money from 'A' & 'B' together, each being liable to pay Rs. 3,500/- from his private property, or they can proceed against any one partner. E.g., 'A', for the full amount. Then after paying the creditors in full, 'A' must try to recover from 'B' Rs. 3,500/-, B's share of the liability.

(2) **Implied Authority**: Every partner has an implied authority to bind the Partnership and other partners by his actions done in the normal course of business. E.g., in placing orders for goods, receiving or paying money for the business. This implied authority is derived from the principle that every partner is the agent of business and every other partner.

(3) **Maximum Good Faith**: Each partner represents the business and every other partner. So, each partner must be most honest and true to every other partner. No business matter must be concealed; no partner can make any secret profit. Any such profits made must be disclosed to all the partners and given to the business. A true account of all business affairs must be given to all the partners.

(4) **Non-transferability of Interest**: Partnership is based on mutual trust, confidence, and good faith among all the partners. So, no partner can transfer or sell away his interest in

the business without express consent of all the other partners. Transfer of a partner's interest even by inheritance is not possible unless consented to by all the other partners. E.g., A, B & C are partners. A dies. A's son can not become a partner unless B & C agree. But he can claim A's share of profits and property in that business.

(5) **Optional Registration:** Law provides for registration of Partnership, but it is not compulsory and can be done any time before closing the business. But an unregistered Parnership suffers many serious handicaps.

(6) **No Statutory Audit:** Since Partnership is based on trust and confidence among the partners, law has not stipulated compulsory audit of annual accounts by qualified persons.

(7) **No Perpetual Eaistence:** A Partnership is not legally separate from the persons forming it. So, any change in the composition of partners affects the business unless partners agree otherwise.

## ORGANISATION & MANAGEMENT

### Formation

It is very easy to form a Partnership. Mere agreement between persons for sharing the results of a business done in common is enough. Not many legal formalities are involved but the persons must have legal capacity to make an agreement and business must not be illegal.

The agreement among partners must be preferably in writing to avoid future quarrels and costly litigations. Such written agreement among partners is known as **Partnership Deed or Articles of Partnership**.

The Partnership Act provides for registration, but it is not a condition precedent to the creation of the Partnership. A Partnership can remain unregistered, but will face insurmountable hardships. So, it can be stated that registration is indirectly made compulsory.

**Duration**

The period of the Partnership depends on agreement. If a period is agreed, the business comes to an end on the expiry of that period. Generally, a Partnership continues as long as partners desire such association. Legally a Partnership has no separate parsonality. So, retirement, death, insolvency or insanity of a partner terminates that Partnership originally started by those partners. This is subject to agreement among the partners. If one partner retires and others agree to continue the same business under the old name and style, then that Partnership will continue after settling the claims of the outgoing partner.

**Management and Control**

Since law empowers every partner with equal right of management and control of the business, all partners can actively participate in running the business. But practical considerations may make the partners nominate one or a few among them to run the business. Then the other partners will be passive and will not conduct the daily affairs of that business. But the right of even such partners to control the business cannot be denied.

Plurality of membership allows for division of labour in a Partnership. The work of running the business can be divided among the partners to suit their special talents. E.g., one partner may look after purchasing, another after marketing and so on. Similarly branch expansion is also possible as each partner may be put in charge of a branch.

It must be noted that, in Partnership, all routine and ordinary matters can be decided by majority decision among the partners. But all matters fundamental to the business, e.g., admission of a partner, changing nature of business, etc., must be agreed by all the partners without any exception i.e., there must be unanimous consent of all partners.

## PARTNERSHIP BUSINESS—AN ASSESSMENT

The advantages and shortcomings of Partnership business can be discussed as below;

**Merits**

(1) **Easy Formation :** It is very easy to form a Partnership. There are no cumbersome legal formalities or irksome procedures. Formation expenses are also very small.

(2) **Greater Resources :** Partnership can command greater resources—monetary and managerial. All the partners can contribute capital. But a partner can join even without any capital-e.g., a person without money but having much business skill and experience. Matching of money with different types of managerial talents is possible.

(3) **Quicker and Better Business Decisions :** 'Two heads are better than one'. In Partnership there are many persons. So business problems can be thoroughly discussed. The best decisions can be arrived at based on the collective wisdom of all the partners.

(4) **Personal Attention :** Active participation of partners in business will ensure personal attention in every aspect of business. This results in greater managerial efficiency and better utilisation of resources. Running cost can be reduced as paid managers need not be appointed. Labour troubles can be minimised due to personal contact with workers.

(5) **Risk-sharing :** All partners share profits and losses. The business risks fall on many persons, each bearing only a small amount. So, new and untried business ventures can be taken up more boldly.

(6) **Minority not oppressed :** Every important matter connected with the business must be decided only by unanimous agreement of all the partners. So, the majority of partners cannot disregard the interest of the minority of partners. Minority interest is well-protected.

(7) **Flexible Operations :** By mutual consent, the partners can change the business as they like very easily. So business can always be responsive to changing needs. Closure or shifting of the business is also not difficult.

(8) **Benefit of Unlimited Liability.** The unlimited joint and several liability of every partner makes each partner take greatest care in running the business properly and safely. The total borrowing capacity of the business is also enhanced as the private properties of all the partners can stand security for such loans.

(9) **Ownership and Control in Same Hands:** The partners who own the business have the right to manage it. So, there is unity of ownership and control of the business in the same hands. There can be no conflict of interest between owners and management.

(10) **Business Secrets Well-kept:** Partners must have mutual trust and good faith. This makes all partners maintain business secrets. The affairs of the Partnership need not be made public. So, outsiders cannot know anything about the business.

(11) **Very Little Government Control:** Law does not impose many rules and regulations on Partnership business leaving much for agreement among the partners. Even registration is not compulsory and is also very cheap, easy and simple.

**Drawbacks**

A Partnership is not an unmixed blessing. It has the following demerits:

(1) **Huge Finance Not Possible:** Restriction on total membership to 10 in banking and 20 in other businesses limits the scope for raising huge capital. So, very big industries cannot be started as Partnership concerns.

(2) **Future Disharmony:** Many a thriving Partnerships had been stifled to death by frequent disputes and quarrels among the partners. This danger, not apparent in the early stages, crops up when the business makes huge profits. Such bickerings among partners affect the reputation of the business but can be avoided by proper selection of partners.

(3) **Lack of Perpetuity** : Partnership is not separate in law from the partners composing it. It is affected by any change in the partners. So, unless all partners agree on continuance of old business, the Partnership ends when a partner leaves the business. Such instability hampers business expansion and smooth progress. Another danger is the loss of goodwill on exit of a partner even if the others continue the business on old lines.

(4) **Unlimited Liability** : Unlimited Liability, which is joint and several, enables creditors of the business to claim against private assets of any partner. So, many rich persons, eager to do business, are hesitant to join as partners, out of fear of losing their private properties, if the business fails. Another demerit is that unlimited liability makes the partners carry on only routine business which is proved safe. They will not embark on bold ventures which they feel may prove risky.

(5) **Danger of Implied Authority** : Every partner has a right to legally bind the business and every other partner by his actions in the normal course of business. A dishonest or inefficient partner may bring calamity to others by his actions.

(6) **Non-transferable Interest** : The capital invested in a Partnership is not liquid because it cannot be transferred without the consent of all the partners. This deters many people from investing in Partnership.

(7) **Delay in Decisions** : Decision making in Partnership may be more sound, but may involve delay. Sometimes some very important matters may not, be decided as one partner may object and unanimous consent cannot be obtained. This may affect the interests of the business.

**Types of Partnership**

Classification of Partnership can be on the basis of nature of partner's liability or duration of Partnership. Based on liability, we have General Partnership and Limited Partnership. Based on duration, there are Partnerships at Will and Particular Partnerships.

(1) **General Partnership:** Here every partner has unlimited business liability. Every partner can participate in the managment of the business. In India all Partnerships are legally regarded only as General Partnerships.

(2) **Limited Partnership:** This type is found in England and regulated by the English Limited Partnership Act, 1907 Here, there must be at least one partner with unlimited liability and one or more partners with limited liability. A limited partner is liable for business debts only upto his total capital contribution. His private property is safe.

(3) **Partnership at Will:** In this type the business is carried on for any period of time according to the desire of the partners. The Partnership can be terminated, if any partner notified the others of his desire to quit.

(4) **Particular Partnership:** This is a Partnership formed for a temporary period or to do a specified business. It will come to an end when the agreed period expires or when that specified business is completed. E.g., a Partnership between A & B to buy and sell new clothes for the 1978 Diwali season or a Partnership between two persons to construct a cinema hall for a price. This Partnership will come to an end when the 1978 Diwali season is over or when the cinema hall is built and the price received.

**Kinds of Partners**

A Partnership may have different kinds of partners.

(1) **Active Partner:** A partner who is in-charge of manging the business is an Active Partner. Other names are Managing Partner or Working Partner. He also contributes capital but sometime may not do so. He will get his agreed share of profit or loss. But he cannot claim separate remuneration for management work unless all partners agree. Normally persons with business skill become active partners.

(2) **Dormant Partner:** This partner only gives capital without managing the business in return for agreed profit or loss share. He is also called Sleeping Partner.

(3) **Nominal Partner :** This partner neither puts capital nor manages the business. He lends his name to be used as a partner in the business, to increase its reputation. He is liable to outsiders for the business debts. He will not share the profits.

(4) **Partner in Profits Only** : Normally every partner must share both profits and losses in agreed ratio or equally. But if all partners agree to exempt any partner from sharing losses, then he will get only his share of profits and need not bear any loss. He is a partner in profits only.

(5) **Partner by Estoppel :** A person may not be really a partner in the business. But, by his behaviour he makes outsiders believe that he is a partner in that business. Then, he is liable to such outsiders entering into business with that Partnership under such belief. Such a person is a 'Partner by Estoppel'. He can not later on deny that he is a partner.

(6) **Partner by Holding Out :** A person who is really not a partner in a business, is described as such. Then he must at once deny it when he comes to know about it. If he keeps quiet, then he is liable to persons who do business with that Partnership believing him to be a partner. Such a person is a 'Partner by Holding Out'.

(7) **Minor as Partner :** Partnership is the result of an agreement. Only persons with legal capacity to enter into agreement can become partners. A minor is any person below 18 years of age and, below 21 years of age, where a guardian is appointed for his property by the court. A minor can not enter into legal agreements.

But, if all the partners agree, he can be admitted into the benefits of the Partnership. He has a right to his share of the profits and property of the business. He can inspect and copy the firm's account. His liability extends only upto his share in the profits and property of the business.

But, when he becomes a major, he must decide whether to continue as a partner or to come out of the Partnership.

**Rights, Duties and Liabilities of Partners**

**Rights :** The rights of partners depend upon the agreement made by them. Partners can spell out their various rights and can enlarge or abridge such rights. But where the partners have no such agreement, the Partnership Act provides for the following rights.

(1) **Right to participate in business :** Every partner with or without capital, has a right to take part in the management of the business.

(2) **Right to be consulted and heard :** In every business matter, every partner has a right to be consulted. Ordinary matters can be decided by majority opinion. But any fundamental matter must have unanimous agreement of partners. Even if the agreement provides for majority decision of partners on all matters, such decision must be taken only in good faith—i. e., for benefit of all partners.

(3) **Right of inspection and copying of books:** Every partner has right to inspect and copy any books of the business.

(4) **Right to share profit :** Every partner has an equal share in the profits of the business.

(5) **Right to interest on capital :** If any partner is to receive interest on his capital, such interest can be given only out of profits.

(6) **Right to interest on advances:** If any partner has lent money to the business in addition to his capital, then such loan must be given interest at 6% p. a.

(7) **Right to indemnity:** Every partner has a right to claim indemnity from the business for payments made or liabilities met by him in the ordinary and proper conduct of the business. E. g., A partner, 'A' spends from his pocket Rs. 20/- to pay freight on goods bought for the business. He can claim this sum from the business. Similarly a partner can claim indemnity for acts done by him to protect the business from loss in an emergency. E.g., To save the business from loss in an out-

break of fire. A, a partner spends Rs. 200/-.from his pocket to engage people to put out the fire quickly. This amount can be claimed by him from the business. But such acts must be done by him in the same way as a man of ordinary prudence will do in his own case under similar conditions.

**Duties**

Partner's duties can be (1) Absolute Duties and (2) Qualified Duties.

Absolute Duties are those duties fixed by law which can not be changed by partners' agreement. They cover every Partnership.

Qualified Duties given in the Act can be modified by partners in their agreement. If there is no agreement, then the qualified duties given in the Act apply.

**Absolute duties are as below :**

(1) **To carry on business for maximum common benefit** : Each partner should apply his skill and intelligence in business to secure maximum benefit to the business. He should never aim at any personal gain.

(2) **To be just and faithful to all partners** : Mutual trust and confidence is the bed-rock of Partnership. So, every partner must always be true and honest to all the other partners.

(3) **To give true and correct accounts** : Every partner must give true and correct accounts to every other partner. He must never make any secret profit for himself. If any such secret profits are made, he must give such profits to the business and fully explain such transactions.

(4) **To give full and detailed information**. Each partner is considered as the agent of the business and of every other partner. So, each partner must always give the fullest and most accurate information about all business matters to all other partners.

(5) **To indemnify the business for loss due to fraud** : A firm may lose money due to neglect or omission or lack of

skill or fraud by a partner in the ordinary conduct of its affairs. If the partner had not acted dishonestly, then such loss will be borne by the firm. But where the partner acted malafide or dishonestly then such guilty partner must make good such loss, that is, only the guilty partner must bear such loss.

(6) **Joint and several liability:** Every partner has unlimited, joint and several liability for business debts. Business creditors can proceed against the private assets of all partners or any particular partner to get their claims satisfied. The partner against whom the creditors proceed must first pay the amount in full and then can claim from the other partners their share of such payment.

(7) **Not to transfer his interest:** Mutual trust and confidence among partners prevents outsiders from joining the business unless consented to by all the partners. So a partner cannot transfer his interest in the business to outsiders, unless all the partners concur. But transfer of a partner's share of profits or property to an outsider can be made, the outsider having no power to manage the business. The outsider will get his share of annual profits and if the business is closed, his share of property of the business.

(8) **Not to do competing business:** A partner should not do any business which is a rival to the Partnership business. If he does so he must account for and pay all such profits from such business to the firm. But if the business is not competing with the firm, he can carry it on. E.g., 'A' is a partner in a Cloth Shop. He cannot have his own cloth shop. But if he opens a medical shop he can run it and keep his profits.

**Partner's Express and Implied Authority**

**Express Authority:** If a partners is authorised by all the partners in their agreement to act on behalf of the buiness, then it is Express Authority of that partner. The firm is liable for all acts done by such partner within such authority.

**Implied Authority :** Partnership results from agreement among partners. Each partner has the authority to act on behalf of the business and on behalf of all the other partners in the ordinary course of business. Each partner is thus the agent of the firm and of every other partner. His acts bind the firm and also other partners. This is the agency relationship between the partner and the firm.

A partner has Implied Authority for the following :

(1) Buying, selling and pledging goods

(2) Borrowing on security of goods

(3) Receiving moneys due to the business and acknowledging same

(4) Accepting, making, issuing Bills of Exchange and Promissory Notes on firm's behalf

(5) Settling accounts of persons dealing with the firm

(6) Employing servants for the firm

(7) Borrowing and repaying loans for the firm

(8) Taking legal action for the firm and defending such actions on behalf of the firm

(9) Operating the bank account on behalf of the firm in firm's name.

The Implied Authority must be exercised in the ordinary course of the business. It must be done in the firm's name or in such a way as to show an intention to bind the firm. It must be to do the usual business carried on by the firm.

**Legal Restrictions on Implied Authority :** A partner has no Implied Authority to do the following things :

(1) to submit a dispute of the firm for Arbitration

(2) to open the firm's bank account in own name

(3) to compromise or relinquish any claim by the firm

(4) to withdraw any suit filed on behalf of the firm

(5) to admit any liability in a suit against the firm

(6) to buy or sell or transfer immovable property on behalf of the firm

(7) to enter into Partnership on behalf of the firm.

For the above acts, a partner must be specifically authorised by all the partners or trade usage must permit such authority. So in such matters, a third party entering into transactions with a partner must first find out whether that partner has the necessary authority. Otherwise, the firm and other partners will not be liable.

**Partner's Liabilities to Third Parties**

Partners are liable to third parties for transactions entered into with them because each partner represents the firm and also other partners.

(1) **Joint and Several Liability:** Third parties can recover their uncleared business debts from the private properties of any one partner or a few or all the partners.

(2) **Indemnity:** If a partner misapplies any money or property received from a third party for the firm, then the firm is liable to indemnity that party for such loss. E.g., a partner misappropriates the money to be sent to a supplier. The firm must pay that supplier this sum.

Retired partners are also liable to third parties for all acts done upto the date of retirement unless the partners agree otherwise

**Partnership Agreement or Deed**

Partnership can be created only by an agreement among the partners. But in India and England, this agreement need not be in writing. In certain European countries, the Partnership Agreement must be written so as to legally bind every partner.

It is always better to have the terms of Partnership written and signed by every partner or his duly authorised agent. Then

future disputes as to understanding of those terms can be avoided.

Such written agreement among the partners is known as a **Partnership Agreement** or **Partnership Deed** or **Articles of Partnership.**

**Contents of Partnership Deed**

A Partnership Deed will usually provide for the following matters.

(1) Name and address of the firm, including branches, if any;

(2) Nature of the business proposed;

(3) Duration of Partnership (if any);

(4) Capital contribution of each partner;

(5) Partner's drawings to be allowed;

(6) Interest, if any, to be allowed on capitals and on drawings.

(7) Ratio of sharing profits and losses;

(8) Salary, if any, payable to active partner or partners;

(9) Procedure for admission or retirement of partners;

(10) Division of work and responsibilities among partners;

(11) Manner of dissolving the firm and the mode of settling accounts on such dissolution;

(12) Maintenance of books and accounts and their audit;

(13) Interest to be allowed on partner's loans and advances to the business;

(14) Method of valuing goodwill and its accounting on admission or retirement of a partner;

(15) Procedure for settlement of disputes among partners by Arbitration.

The contents of a Partnership Deed can be altered only with the consent of all the partners.

**Registration of a Partnership Firm**

In Indian Law, registration of a Partnership is not compulsory. But under English law, it is compulsory. In India, registration can be done under the Partnership Act. This has to be done with the Registrar of Firms in each State and can be done at any time during the existence of the Partnership business. So a Partnership may remain unregistered. But the effects of non-registration are so severe that in practice registration is advantageous.

**Disabilities of Non-Registration**

(1) A partner of an unregistered firm cannot file any civil suit against the firm or against any other partner including an ex-partner for enforcing his contractual rights under the Partnership Agreement or under the Act. But criminal suits are possible.

(2) An unregistered firm cannot file any suit against third parties in any civil court. E.g., for recovering money due. But any criminal action against any third person is not prohibited.

(3) Any third party can take legal action agianst the business or the partners to enforce his rights.

(4) The Partnership or its partners cannot even claim any set-off with third parties based on any contract. Suppose a creditor files a suit against the firm for recovering his dues Rs. 1,000/-. If this creditor is indebted to the firm for Rs. 600/-, the firm cannot claim adjustment of that amount and pay the balance. But claims not exceeding Rs. 100/- are allowed to be set off.

(5) The firm cannot take legal action against its partners.

(6) A partner can sue for dissolving the firm or for realising the properties of a dissolved firm or for settlement of accounts on dissolution.

Non-registration does not affect a Partnership having no place of business in India. It also does not affect the powers of the Court Official to realise the properties of an insolvent partner.

**Registration Procedure**

The partners must give an application with the prescribed fee to the Registrar of Firms in each state where the firm has or wants to do business. This application containing the following particulars must be signed, by all the partners or their duly authorised agent.

(1) Name of the business

(2) Principal place of business and other places of business, if any

(3) Date of admission of each partner

(4) Name and address of each partner

(5) Duration of the firm.

On satisfying himself about the correctness of all the above particulars, the Registrar will enter them in his Register of Firms and give a certificate to the firm. Any change in the above particulars must be intimated to the Registrar at once. For any false details knowingly given, the guilty person is punishable with fine or imprisonment upto three months or both. The entries in the Register of firms are conclusive proof of the correctness of such details

**Dissolution of Partnership Firm**

Dissolution of Partnership firm means putting an end to such relationship. The Indian Partnership Act makes a distinction between Dissolution of the Firm and Dissolution of Partnership.

Dissolutin of the Firm is dissolution of Partnership among all the partners in that firm.

Dissolution of Partnership takes place when one or more partners go out of the business but other partners continue the business. Here the business will continue after re-constitution.

For example, A, B and C are partners in a business. If the three decide to separate, it is 'Dissolution of the Firm'. But if

'A' retires and 'B' and 'C' continue in Partnership, it is 'Dissolution of Partnership'.

**Circumstances for Dissolution of Firm :** A Partnership firm can be dissolved under the following circumstances:

(1) **By mutual agreement :** Partnership is created by agreement among the partners. So it can be dissolved as per agreement among all the partners.

(2) **By notice :** A 'Partnership at Will' can always be dissolved if any partner gives a written notice to other partners of his intention to dissolve the firm.

(3) **On certain events happening:** A Partnership firm is dissolved, if

(i) it is for a fixed period and that period is completed,

(ii) it is to do only certain businesses mentioned and those ventures are completed;

(iii) when a partner dies or is adjudicated as insolvent.

But in the above cases, the Partnership can be continued if all partners agree on such a step.

(4) **Compulsory dissolution :** A firm is compulsorily dissolved when

(i) all partners or all partners execpt one are adjudged insolvent;

(ii) when the business becomes illegal or cannot be carried on as a Partnership.

(5) **By Court**

(i) **Partner's insanity :** If any partner becomes insane the court may order dissolution,

(ii) **Permanent incapacity :** When one partner becomes permanently incapable of being a partner, then any other partner can move the court for dissolution,

(iii) **Misconduct of a partner:** If any partner is guilty of misconduct, then any other partner can file a suit for dissolution.

(iv) **Persistent breach of agreement:** If a partner is always breaking the Partnership Agreement and the other partners find it impossible to do business in Partnership with him, then any other partner can move for dissolution by the Court.

(v) **Transfer of interest:** When a partner transfers his whole interest in the business to a third party or has allowed his interest to be sold under a decree, any other partner can move the court for a dissolution.

(vi) **Continuous loss**; Where the Partnership cannot be run except at a loss;

(vii) **Just and equitable grounds**: Where the court feels that there is due ground or reason for dissolving the firm- Eg., if 'A' and. 'B' are partners and they do not speak to each other.

When a partner applies to the Court for dissolution, the Court may dissolve the firm on any of the above grounds.

**Comparison between Sole Proprietorship and Partnership**

The following are the points of similarity and difference between a Sole Trader and Partnership business.

**Similarities:** Sole Tradershib and Partnership have the following common features:

(1) Easy formation

(2) Flexible operations

(3) No permanent existence

(4) Unlimited liability for business debts

(5) Unsuitable for large industries

(6) No rigorous Government control

(7) No Statutory Audit

(8) Personal attention to details of business

(9) Personalised service to customers and close personal contact with workers

(10) Unity of ownership and control.

**Differences**

(1) **Membership**: In Sole Trader, there is only one owner. In Partnership the minimum membership is two and the maximum is ten for banking and twenty for any other business.

(2) **Capital**: Larger capital is possible in a Partnership.

(3) **Varied resources**: In a Partnership there can be matching of different kinds of talents and wealth. This is not possible in a Sole Trader business.

(4) **Government regulation**: Partnership is regulated by the Indian Partnership Act, 1932. There is no such separate law to regulate a Sole Proprietorship.

(5) **Better decisions**: In a Partnership due to consultation among all partners, better business decisions may result.

(6) **Division of responsibilities**: Work of management can be divided among the partners according to their special abilities. This leads to greater efficiency.

(7) **Joint and several liability**: In a Partnership, every partner is liable for business debts collectively and also individually.

(8) **Created by agreement**: Partnership is created by agreement among the persons forming it.

(9) **Implied authority**: Every partner has implied authority to bind the firm and all the partner by his actions done in ordinary course of the business.

## OBJECTIVE TYPE QUESTIONS

**I. Multiple Choice Questions:**

Choose the correct answer a, b, or c in the following:

(1) Partners share profits and losses

(a) equally

(b) in the capital ratio

(c) in an agreed ratio (c)

(2) The liability of partners in India is

(a) limited

(b) unlimited

(c) equal (b)

(3) A person who is really not a partner but allows his name to be used in the Partnership is

(a) Dormant Partner

(b) Secret Partner

(c) Nominal Partner (c)

(4) Partnership is always created by

(a) agreement

(b) status

(c) written agreement (a)

(5) The maximum membership in a non-banking firm is

(a) ten

(b) fifty

(c) twenty (c)

**II. Fill in the blanks with suitable word or words:**

(6) Sharing of profits is only prima facie evidence of ............

(Partnership)

(7) Members of a Partnership are collectively called a ..........and individually known as..............

(firm, partners)

(8) A partner who manages the business is a..........partner.

(managing/active/working)

(9) In India registration of a Partnership is...........

(optional)

(10) Cessation of relationship among all partners in a firm is dissolution of...........

(firm)

**III. State whether the following are True or False: If false, write the correct statement:**

(11) A partner can not transfer his interest in the firm without the consent of all the other partners.

(True)

(12) Women cannot become members of Partnership business in India.

(False; can become partners)

(13) A minor can enter into a Partnership Agreement.

(False; can be admitted into the benefits of Partnership)

(14) Dissolution of Partnership is subject to agreement among the partners.

(True)

(15) A person receiving a share in the profits of a firm is a partner in that business.

(False; agency relationship essential)

**IV. Match the items in Panel-1 with those in Panel-2:**

| Panel-1 | Panel-2 |
|---|---|
| (16) A person not really a partner but allows himself to be described as a partner | (a) Managing Partner |

| | |
|---|---|
| (17) A person whose name does not appear as a partner, but who is really a partner | (b) Salaried Partner |
| (18) A person, not a partner but lends his name to be used in the Partnership | (c) Partner by Holding Out |
| (19) A person who puts capital in the firm but does not participate in its daily management | (d) Secret Partner<br>(e) Guaranteed Partner |
| (20) A person who is a partner in a business and actively takes part in its management | (f) Nominal Partner<br>(g) Sleeping Partner |

(16—c; 17—d; 18—f; 19—g; 20—a)

**Short Essay Type Questions** (One page answer)

(21) Define Partnership and from the definition explain its legal features.

(22) Explain "Partnership Deed".

(23) What are the rights of a partner?

(24) Explain: Implied Authority of a partner. For what purposes it is not available?

(25) What is Registration of Partnership under the Indian Partnership Act, 1932? What are the effects of non-registration?

(26) Discuss the legal position of a minor in Partnership.

(27) Explain the kinds of Partnership in India.

**Long Essay Type Questions** (Three pages answer)

(28) Explain the advantages and limitations of Partnership.

(29) Discuss the rights and duties of partners.

(30) Describe the various types of partners.

(31) Describe the features of Partnership business.

(32) What are the circumstances when dissolution of the firm is possible? Is dissolution of firm same as dissolution of Partnership?

(33) Compare and contrast a Partnership with a Sole Proprietorship.

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CHAPTER III

# COMPANIES

## (a) Its Nature

The term 'Company' refers to an association of a number of individuals formed for some common purpose—usually for carrying on business. **Lord Lindley** defined a company as follows: "By a company is meant an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business and who share the profit and loss as the case may be arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons, who contribute it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his share".

This definition brings out the following characteristics of a Company:

(i) It is an association of many persons.

(ii) These persons contribute capital.

(iii) The capital is divided into shares.

(iv) It is to be employed in some business.

(v) Members who contribute capital are entitled to share the profit or loss.

But even this definition is not complete. Besides the above, a Company, possesses also the attribute of 'a corporate personality', namely separate existence and perpetual succession. We can now say that "a Company" is an artificial person, created by law with perpetual succession and a common seal.

**Features of a Company**

(1) **Legal Entity:** The outstanding feature of a Company is its separate legal existence. On registration under the

Companies Act, it gets a separate personality of its own. In the eyes of law it is a person, different from the members composing it. As such, it can own and transfer property, can employ people, can enter into contracts and can sue and be sued in its own name like any other natural person. A Company does not lose this individuality just because one person holds almost the entire bulk of its shares. Although all the shares may be practically controlled by one person, in law a Company is a distinct entity.

(2) **Limited Liability**: Another outstanding feature of a Company is that the liability of its members is limited. He is liable for the debts and liabilities of the Company only upto the nominal value of the shares he holds. Once he pays their full value, he will not be called upon to contribute any further amount whatever be the magnitude of the Company's loss.

(3) **Separate Property**: We have already stated that as a result of corporate personality a Company is entitled to own property in its own name. Even though members own shares, they do not have any proprietory interest in the property of the Company; in other words, they are not its joint owners. "The property of the Company is not the property of the shareholders; it is the property of the Company". That is why a change in membership does not affect in any way the property of the Company.

(4) **Transferability of Shares**: The capital of a Company is divided into shares of a fixed denomination. These shares are transferable in the manner provided by the Articles of the Company. Thus a member by selling his shares in the open market gets back easily the amount he has invested. By Subscribing to the shares of a Company, an investor does not get himself tied down to the wheels of the Company permanently. Whenever he wants to get out of it, he can do so by transfering his shares. For this purpose he need not get consent of any other member. The only thing he has to do in this connection is to go through the procedure laid down in the Articles of Association of the Company.

It is this facility of easy transferability of shares coupled with the feature of limited liability that make a Joint Stock Company very popular.

(5) **Perpetual Succession**: A Company is independent of the lives of its members. Hence their death or insolvency has no impact whatsoever on its life. A Company which gets its corporate existence through the process of law can be wound up and dissolved only by following the provisions of the Companies Act. No other contingency which afflicts human beings and takes life out of them has any effect on the continued existence of a Company. There may be a complete change in the members Composing it. Even then the Company continues its affairs unaffected and unconcerned.

For example, A, B, C, D, E, F and G who were instrumental in bringing a Company into existence were its original members. Later on, all of them transferred their shares to T, U, V, W, X, Y and Z. Thus the Company which was composed of A, B, C, D, E, F and G originally is now composed of T, U, V, W, X, Y and Z. Despite this total change in its membership, the Company remains the same entity with the same rights and privileges. It does not have a natural death through ageing. As **Lord Gower** said, "Members may come and go but the Company can go on for ever."

(6) **Common Seal**: A Company, though recognised in law as a person, cannot sign any document for itself. Hence every Company has its own common seal with its name engraved thereon. This seal, when affixed on any document, is taken to be the signature of the Company.

(7) **Separation of Ownership and Management**: Mere shareholding does not entitle one to participate in the management which is entrusted to a Board of Directors. Directors are the elected representatives of the shareholders. This is in striking contrast to a Partnership where every partner is entitled to take part in the management of the affairs of its business. The divergence between ownership and management is yet another feature of a Joint Stock Company.

**Distinction Between A Company and A Partnership**

An analysis of the differences between these two forms of organisations will make our understanding of their respective features clearer. The distinction between a Company and a Partnership is as follows:

(1) **Registration**: The Indian Partnership Act of 1932 does not make registration of a Partnership compulsory. It means that a Partnership firm may or may not be registered.

On the other hand every Company other than a Chartered Company is to be compulsorily registered either under the Companies Act, 1956 or under the Special Act which has created it.

(2) **Separate Existence**: A Partnership has no legal existence, apart from the partners who constitute it. It is not considered to be distinct from its partners.

As regards a Company, on registration, it gets a legal entity. Because a Company is considered to be a person altogether different from its members, its acts do not hold the individual members liable for them.

(3) **Membership**. A minimum of two persons is necessary to form a Partnership as well as a Private Limited Company; while a minimum of seven is necessary for a Public Limited Company. In the case a Partnership, maximum membership is restricted to ten for doing banking business and to 20 for any other business.

For a Private Company, maximum is limited to 50, excluding employee—members, while there is no such maximum limit for a Public Limited Company.

(4) **Liability**. The liability of a partner is unlimited. This is a serious drawback in that even the private properties of a partner may have to be used for paying the debts and liabilities of the firm. In other words, a partner is personally liable to the full extent for all the debts contracted by the firm.

The liability of a member of a Company on the other hand is limited to the nominal value of the shares held by him. If the full value of the share is paid, no more liability attaches to him. Even though Unlimited Companies can also be registered under the Companies Act, they are non-existent and therefore not taken into account.

(5) **Separate Property**: The property of a Patnership firm is a property of the partners who constitute it; they are, in effect, the joint owners of the property.

Whereas in the case of a Company, the property belongs to the Company and the shareholders are not its owners. This is because a Company, as a juridical person, owns, holds and disposes of properties in its own corporate name.

(6) **Principal-Agency Relationship**: The essence of Partnership is the principal and agency relationship which subsists among partners. Every partner is at the same time a principal and an agent. Consequently he can, by his acts, bind the firm and is similarly bound by the acts of other partners.

Such a relationship is unthinkable in a Company, where a shareholder has no right to act on its behalf and to bind other shareholders thereby.

(7) **Transferability of Shares**: A partner cannot transfer his interest in the firm without the consent of all other partners because Partnership is based on mutual trust and confidence. Admission of a new partner without the unanimous approval of all may, by sowing seeds of dissension among partners, rudely shake this very foundation.

The shares of a Public Company, on the other hand, are freely transferable. A shareholder can transfer his shares without having to obtain the consent of other members. The ease with which transfer of shares can be effected has encouraged the investing public to buy the shares of Joint Stock Enterprises.

(8) **Joint and Several Liability**: The liability of a partner is not only unlimited but joint and several too. If a decree is

passed against a firm, the creditor can get it executed by any partner, who in turn, can recover the proportionate amount from other partners. But the creditors of a Company can proceed against the Company alone.

(9) **Contract with the Concern :** A partner cannot enter into contracts with his firm whereas a member of a Company can do so.

(10) **Duration .** Death, insolvency or lunacy of a partner has the effect of dissolving the Partnership while no such events can terminate the existence of a Company which has perpetual succession.

Because of transferability of shares, there may even be a total change in its membership. Yet the Company remains the same entity and continues its business unaffected till it is liquidated in accordance with the provisions of the Companies Act.

(11) **Management:** Every partner has a right to participate in the management of the affairs of the firm. Partnership business is carried on by all or any of them acting for all.

But in the case of a Company, its management is entrusted to a Board of Directors, which is its ultimate executive authority. Any individual member by virtue of his shareholding has no claim to manage its affairs. This separation of ownership from management is another important point of distinction between a Partnership and a Company.

(12) **Documents Defining Scope of Activity :** The Partnership Deed contains the mutual rights and duties of partners and the method of its management. It is easily alterable.

The Memorandum of Association of a Company,by stating the objects and purposes of starting the company, regulates its relations with the creditors and outsiders. The Articles of Association contain rules and regulations for the internal management of the Company. These documents can be altered only to a limited extent as laid down in law.

(13) **Audit**: A Partnership firm is under no obligation to get its annual accounts audited by qualified auditors, whereas books of accounts of Companies must be so audited. Companies Act contains provisions for the appointment, remuneration and removal of auditors.

(14) **Statutory Obligations**: Formation of a Partership is easy; it is free from many of the cumbersome procedures and statutory obligations to which Companies are subjected.

Every Company has to file a number of documents and returns right from its inception upto its dissolution. Further, it is bound to maintain certain records and registers. There are no such statutory obligations for a Partnership to comply with.

## KINDS OF COMPANIES

Companies are of many types. Broadly speaking they are of three kinds:

(1) Chartered Companies.

(2) Statutory Companies.

(3) Registered Companies.

(1) **Chartered Companies**: Such companies were created by a Royal Charter granted by a King or Queen of a country. Hence they were known as Chartered Companies. For example, East India Company was a Chartered Company created by the Sovereign of Great Britain in the 17th century. The Royal Charter conferred upon such Companies powers to have an unrestricted corporate capacity. The Companies Act does not apply to them.

The formation of such Companies for trading purposes is a rare phenomenon nowadays. In India, it is simply out of question because we have neither a King nor a Queen.

(2) **Statutory Companies**: Companies established by Special Acts of Parliament are known as Statutory Companies. Reserve Bank of India, State Bank of India and Life Insurance

Corporation of India are examples of this type. Public utility undertakings such as Railways and those concerned with the provision of such essential items as gas and electricity are also usually created by Special Acts of the legislature. Their activities are regulated by the Special Acts which create them.

(3) **Registered Companies** : Companies incorporated under the Companies Act, 1956 or under the earlier Companies Act are known as Registered Companies. As the name itself implies, such Companies are brought into existence after registering certain documents with the Registrar of Joint Stock Companies. We are mostly concerned with this type of Companies. The Companies Act, 1956, as amended from time to time, governs the formation, working and liquidation of these Companies.

From the point of view of liability, the following kinds of Companies can be registered under the Companies Act:

(a) Unlimited Companies;

(b) Companies Limited by Shares;

(c) Companies Limited by Guarantee.

(a) **Unlimited Companies** : A Company, not having any limit on the liability of its members, is termed as an **Unlimited Company**. It only means that in the event of winding up, and if the assets of the Company are insufficient to meet the claims of creditors, its members are liable to an unlimited extent. In other words, they will be called upon to pay from their private properties. Such Companies are like big Partnerships with a fundamental difference as regards separate personality. An Unlimited Company has a legal entity distinct and separate from its members whereas a Partnership has no such corporate existence As a result, the members of an Unlimited Company cannot be directly proceeded against by its creditors. Unlimited Companies are not popular and hence they are practically non-existent.

(b) **Companies Limited by Shares** : Members of a Company, limited by shares, will not be called upon to pay anything

more than the nominal value of the shares held by them. If the shares are all fully paid up, members are not at all liable to contribute anything when the Company goes into liquidation, even though its assets are not sufficient to pay off its liabilities. In other words, their liability is limited to the amount remaining unpaid on shares held by them.

Such Companies may be either Public Limited Companies or Private Limited Companies.

(c) **Companies Limited by Guarantee**: Such Companies are known as 'Guarantee Companies'. They are of two types.

(i) Companies Limited by Guarantee having no Share Capital

(ii) Companies Limited by Guarantee having Share Capital

Companies Limited by Guarantee are usually formed to promote art, sports, education, charity etc. They raise resources by getting subscription fees from their members besides donations and endowments.

The number of members with which a Guarantee Company is proposed to be registered must be stated in its Articles of Association. However the number can be increased by passing a resolution to that effect.

(i) **Guarantee Companies Having No Share Capital:** These Companies have no share capital. The amount of guarantee is mentioned in the Memorandum of Association. Each member gives an undertaking in the Memorandum to contribute a fixed amount for payment of the debts and liabilities of the Company in the event of its winding up. Thus the liability of its members arises only when the Company goes into liquidation and its liabilities remain undischarged owing to the insufficiency of its assets. Members will then be called upon to contribute upto the amount guaranteed by them.

(ii) **Guarantee Companies Having Share Capital**: Since this type of Company has a share capital, it has to state in

its Memorandum, the amount of the share capital with which it is proposed to be registered and its division into shares. Further, it has also to state the amount of guarantee.

As for the liability, it is two-fold. As a shareholder, a member is liable to the extent of the amount remaining unpaid on the shares held by him. As a guarantor, he is also liable upto the amount guaranteed by him. For example, a member has 5 shares of Rs. 100 each on which Rs. 80 per share has been paid up. Further he has undertaken a guarantee of Rs. 200. Assuming insufficiency of assets at the time of winding up, the liability of this particular member is Rs. 300—liability on account of shares being Rs. 100 (the unpaid amount of the face value of 5 shares at Rs. 20 each) and the guarantee being Rs. 200. Thus it will be clear that in addition to the usual liability on account of shares, a member of a Guarantee Company having a Share Capital has also to fulfil his obligations on account of guarantee.

**Government Companies** *:* According to Section 617 of the Companies Act, Government Company refers to any Company in which not less than 51 per cent of the paid-up share capital is held by the Central Government, or by any State Government or State Governments. The shares held by the Central Government as well as those by one or more State Government must be considered for calculating this percentage of shareholding.

**Foreign Company***:* Foreign Company is a Company which having been incorporated outside India, has a place of business or places of business in India. The provisions of the Companies Act apply to Foreign Companies also as regards their working in India.

**Holding Companies**: Holding Company is one which holds more than 50% of the nominal value of the Equity Share Capital of another company or one which has power to appoint or remove a majority of directors of another Company. The Company, so controlled, is called its "Subsidiary."

**Public Companies**: The Companies Act does not give a direct definition of a public Company. Section 3 (2) (iv) merely says "Public Company means a Company which is not a Private Company". The minimum number of members required for a Public Company is seven. As for maximum number, there is no limit. Shares of a Public Company are transferable. It can issue a "Prospectus" inviting the public to subscribe for any shares or debentures of the Company. That is, any member of the public can purchase its shares and debentures. Thus unlimited membersihp, free transferability of shares and public subscription (purchase) of its shares or debentures are the fundamental characteristics.

With a view to protecting the interests of the shareholders many restrictions have been placed by the Companies Act on the Public Companies, and strict control is exercised over their working at every stage by the Government.

**Private Companies**: A Private Company is a Company which by its Articles,

(i) restricts the right to transfer its shares;

(ii) limits the number of members to fifty; and

(iii) prohibits any invitation to the public to subscribe to the shares or debentures of the Company.

A minimum of two persons is necessary for a Private Company; maximum is limited to fifty. While calculating the maximum, however, the following should be excluded :

(i) Such of the shareholders who are at the same time employees of the company;

(ii) Such of the shareholders who were former employees of the company and while in employment were also members of the Company. (That is even though they are no more in service of the Company, continue their membership of the Company acquired during their employment).

In short, while counting the maximum number, the present as well as the past employee-members should be omitted.

Thus limitation on the maximum membership, restriction on transferability of shares and prohibition of public subscription of shares are the essentials which characterise a Private Company.

Every Private Limited Company should use the words '(Private) limited' at the end of its name. Private Companies are exempted from complying with many of the requirements which are compulsory for a Public Company. The exemptions enjoyed by the Private Company are explained under a separate heading.

**Differences between Private and Public Companies**: We have already seen the definitions of Private Companies and Public Companies. From the above definitions and other provisions of the Act, some of the important differences between these two types of companies can be noted as under :

(1) A Private Company can be registered under the Companies Act just with two persons, but the incorporation of a Public Company requires a minimum of seven members.

(2) A Private Company cannot have more than fifty members, excluding employee-members, both present and past, while theree is no limit to the maximum membership of a Public Company.

(3) A Private Company is prohibited from issuing a 'Prospectus' inviting the public to buy its shares or debentures whereas a Public Company is entitled to do it.

(4) The Articles of a Private Company restrict the right to transfer its shares. But the shares of a Public Company are freely transferable in accordance with the procedure laid down in this regard.

(5) The words '(Private) Limited' form part of the name of a Private Limited Company, while the word 'Limited' alone is added to the name of a Public Limited Company.

(6) A Private Company can commence business as soon as it gets the Certificate of Incorporation fromt he Registrar of Joint Stock Companies but a Public Company has to observe some more formalities.

(7) A Public Limited Company has to file a Statutory Report with the Registrar and hold a Statutory Meeting. A Private Limited Company is exempt from this.

(8) A Public Company can issue only two kinds of shares; i. e., Equity and Preference, whereas a Private Company can issue any class of shares. (for example, Deferred Shares)

(9) A Private Company shall have at least two Directors while a Public Company shall have at least three Directors.

(10) A person cannot be a Director in more than twenty Public Companies. A person can be a Director in any number of Private Companies.

**Privileges Enjoyed by Private Companies**

The procedure to be followed in forming a Private Company is more or less the same as the one to be adopted for a Public Company. But the fact is that even the limited membership is usually restricted to relatives, friends and their close associates in the case of a Private Company. Members of the general public are not interested in it, as they do not have any opportunity to buy shares in it on the strength of a Prospectus.

The necessity for protecting the interests of the investing public is not keenly felt in Private Companies. Hence many of the restrictions imposed by the Companies Act on Public Companies do not apply to Private Companies. It must be noted here that many such exemptions are not available to Private Companies which are subsidiaries of Public Companies. While

discussing the differences between Public Companies and Private Companies, we have already seen many of the exemptions. Anyhow some basic exemptions are listed below :

(1) A Private Company can be incorporated with even two persons.

(2) The issue of any Prospectus for the purpose of raising capital or borrowing by way of Debentures is prohibited. Hence the question of filing a copy of the 'Prospectus' or 'A Statement in lieu of it' with the Registrar does not arise.

(3) A Private Company can commence business on getting the Certificate of Incorporation from the Registrar.

(4) It is not required to hold a Statutory Meeting or file a Statutory Report with the Registrar.

(5) A Private Company can issue Deferred Shares also.

(6) The minimum number of directors for a Private Company is only two.

(7) The Directors of a Private company need not retire by rotation.

(8) A person can be a Director in any number of Private Companies.

## (b) Incorporation

We all know that a **Company** is "an association of persons to carry on some business for the acquisition of gain". Certain preliminary steps are to be taken for bringing a Company into existence. Right from the time of conceiving the idea of starting a Company till it is actually allowed to commence business, three important stages have to be crossed. They are Promotion, Incorporation and Commencement of Business.

**Promotion**

This term denotes the process by which the idea of forming a Company results in its Incorporation. Persons who develop the idea and take the necessary steps to accomplish that purpose and by whose pioneering efforts a Company is incorporated are designated as 'Promoters'. **Bowen, L. J.** observed, "The term 'promoter' is a term not of law but of business, usually summing up in a single word a number of business operations familiar to the commercial world by which a Company is generally brought into existence".

**Different Stages of Promotion**

The first stage of promotion starts with the discovery of an idea or a business proposition. Of the several opportunities that present before a promoter, he has to choose a suitable one having regard to his ability and practical possibilities.

Then comes the stage of investigating the feasibility of the project—the estimated output, likely turnover, demand position, outlay on plant, machinery, buildings and other assets and working capital needed etc. He also plans for securing necessary funds by way of share capital, long-term borrowings etc., and collects information regarding the availability and uninterrupted supply of raw materials, availability of skilled labour, power, transport facilities etc., at the proposed site. In short at this stage, he makes himself sure about the viability and profitability of the project he has on mind.

The promoter once convinced of the feasibility of his scheme moves to the next stage of collecting the required number of persons who are prepared to associate themselves with this venture, and are willing to act as its first directors; Such vital issues as Name of the proposed Company, its Registered Office, amount of Capital etc., are settled at this stage. Preliminary contracts for acquisition of necessary capital assets, patent rights etc., are also finalised.

Now the promotion work enters the final stage of Incorporation. With the assistance of legal experts, he gets the Memorandum and Articles of Association drafted and printed; files the

declarations required, pays the necessary fees and stamp duties and thus gets the company incorporated. His work does not cease with the getting of Certificate of Incorporation. He is prepared to complete the other formalities required for a Public Company, namely, preparing, filing and publishing of Prospectus, arranging issue of shares, making agreement with under-writers, etc. He defrays the Preliminary Expenses. He works ceaselessly till the company, the fruit of his conception and sincere endeavour, gets the Certificate from the Registrar to commence business.

The Promoter, in consideration of this arduous and uphill task is, of course, remunerated. This may be in the form of a lump sum payment or by way of issue of shares and debentures of the Company he floats. When he sells his own business to the proposed Company, he may be paid a higher value than its market value.

**Formation of a Company**

We have seen in detail the promotion of a Company and very briefly the role of a promoter even at the stage of Incorporation.

Actual formation of a Company, registration and commencement of business are described below:

(a) **Registration of a Company:** We have already stated that after completing all the preliminary steps like conducting feasibility survey, preparing project estimates etc., promoters get hold of persons who are ready to associate themselves with this project. All matters relating to the Company, capital to be raised, rules and regulations are discussed and decided upon.

(b) **Sanction For Capital Issue:** If the proposed Company is to issue capital in excess of Rs. 25 lakhs, the consent of the Controller of Capital Issues is to be obtained. In such a case, an application must be made to him along with the necessary fee and a copy of the Draft Prospectus.

(c) **Approval of Name**: A Company can choose any name. The only restriction is that it should not closely resemble the name of an existing Company. Hence the first task of the promoters before incorporation is to ascertain from the Registrar if there would be any objection to the proposed name of the Company. For this purpose, an application is to be submitted to the Department of Company Law Administration, Government of India through the Registrar of the State in which the Registered office of the Company is to be situated.

(d) **Filing of Documents**: For registration, the following documents are to be presented to the Registrar :

(1) Memorandum of Association : This is, as it were, a Charter of the Company, describing its constitution. The name of the Company, the location of its Registered office, objects to be pursued by it, capital, liability of its members are all stated in this document. Two or more in the case of a Private Company and seven or more in the case of a Public Company, must sign the Memorandum.

(2) Articles of Association : This is another important document prescribing regulations as to the management of the internal affairs of the Company. Filing a copy of the Articles is a 'must' in the case of an unlimited Company, a Guarantee Company and a Private Company; but it is only optional in the case of a Public Company. If it does not file Articles of its own, the regulations contained in Table A in the First Schedule to the Act will apply.

The subscribers of the Memorandum must sign the Articles of Association also. (A detailed description of the two documents is given under separate headings.)

(3) Statement of Nominal Capital : Where the capital issue exceeds Rs. 25 lakhs, the consent of the Controller of Capital Issues must also be filed with the Registrar.

(4) Consent to act as Directors : In the case of a Public Company, persons who have been named as Directors in its Articles must give their consent in writing to act as such Directors. Their consent along with a written undertaking that they will take their qualification shares from the Company and pay for them must be filed with the Registrar :

(5) A declaration that all the requirements of the Act relating to registration have been complied with must also be filed. This declaration must be given by any of the following persons :

(a) an advocate of the Supreme Court or High Court;

(b) a Chartered Accountant, practising in India, who is engaged in the formation of the Company;

(c) a person named in the Articles as a Director, Manager or Secretary of the Company.

The Registrar will examine the documents enumerated above. If he is satisfied that all the statutory requirements have been complied with by the Company, he will retain and register the Memorandum and Articles. He will then issue a certificate known as the Certificate of Incorporation. This certificate is a conclusive evidence that the Company has been duly registered under the Act. In effect, the Company is born on registration and it has acquired a corporate existence. The Company's life starts from the day mentioned in the Certificate. This Certificate is so conclusive that nothing can invalidate its Incorporation later; even if that Registrar ought not to have issued it on certain material grounds, the Certificate of Incorporation is still conclusive. Even if the objects are illegal, the legal personality of an Incorporated Company can not be assailed. The only remedy is to wind up the Company.

A Private Company can commence business immediately upon registration; but a Public Company has to get a Certificate of Commencement of Business also from the Registrar. The following additional steps are necessary.

**Prospectus**

A Public Limited Company may approach the general public for securing its capital. For this purpose, it has to draft what is known as 'Prospectus'. It is a statement containing all material facts about the Company, its promoters, its agreements on hand, its future prospects etc. It contains, in short, all essentials which will induce the investing public to buy its shares. But any mis-statement in the Prospectus will render the Directors and other officers responsible for its issue liable to heavy penalties.

A copy of the Prospectus signed by all the Directors must be delivered to the Registrar before issuing it to the public.

The Prospectus delivered to the Registrar must be accompanied by the written consent of persons named therein as its Auditor, Legal Adviser, or Banker to act in that capacity.

**Statement in lieu of Prospectus**

If it is possible for the promoters to raise the entire capital through their friends and relatives, they may refrain from approaching the public for this purpose. They need not issue a Prospectus in that case. However, they must file with the Registrar, a Statement in lieu of Prospectus at least three days before allotment. This Statement must contain almost all those particulars that find place in a Prospectus.

**Minimum Subscription**

In the opinion of the Board, Minimum Subscription is the amount which must be raised by the issue of shares to meet the following expenditure:

(i) the purchase price of any property purchased or to be purchased;

(ii) Preliminary Expenses yet payable including Under-writing Commission;

(iii) repayment of money borrowed for the above purposes;

(iv) Working Capital;

(v) any other expenditure with details.

The amount of Minimum Subscription must be stated in the Prospectus. Unless applications for shares at least upto the Minimum Subscription are received and sum payable on application for the stated amount is received, Directors cannot proceed with the 'Allotment of Shares.'

**Declaration of Compliance**

(i) Shares at least upto the amount of Minimum Subscription must have been allotted;

(ii) The Directors must have paid, in cash, the Application and Allotment Money in respect of shares taken by them;

(iii) No money must have become repayable because of failure to obtain permission to deal in on the Stock Exchange applied for.

A declaration to the effect that the above conditions have been fulfilled must be signed by any Director or Secretary of the Company.

**Certificate of Commencement of Business**

The Registrar thereupon scrutinises the declaration. If he is satisfied, he issues a Certificate of Commencement of Business. This entitles the Company to commence business on the day mentioned in the Certificate.

## MEMORANDUM OF ASSOCIATION

The first step in the formation of a Company is the preparation of a document called 'Memorandum of Association'.

According to Section 2 (28) of the Act, "Memorandum" means the Memorandum of Association of a Company as originally framed or altered from time to time in pursuance of any Companies Law or of this Act. But this definition does not give us any clear idea as to its real meaning. It contains such fundamental clauses as Name clause, Objects clause, Liability clause and Capital clause that it can be aptly described as the very foundation on which the entire edifice of the Company stands.

In a leading case on the point, **Justice Brown** observed: "The Memorandum contains the fundamental conditions upon which alone the Company is allowed to be incorporated. They are the conditions introduced for the benefit of creditors and the outside public as well as of the shareholders." The above observation makes it clear that the document defines its relation with the outside world.

Shareholders, creditors and those who have dealings with the Company can know from the Memorandum what powers the Company has and what activities the Company is permitted to undertake under the Memorandum. In short, the Memorandum of Association of a Company prescribes its area of operation and the limits beyond which it cannot go. Any act of the Company outside the scope set out by its Memorandum is not binding on it.

Memorandum of Association must be printed and divided into paragraphs. Paragraphs must also be numbered consecutively.

**Contents of the Memorandum**

(1) **Name Clause** : This states the Name of the Company. A company can adopt any name of its choice. But if the name is undesirable in the opinion of the Central Government, it may reject its registration in that name. For example, if the name of the proposed Company closely resembles that of an existing Company, the Central Government will declare it undesirable. This is because the public may be misled to believe that the two businesses are connected ones.

Further, the name of the Company must end with the word 'Limited' in the case of a Public Limited Company and with the words "Private Limited" in the case of a Private Limited Company. This makes it clear to all concerned that the liability of the members is limited.

Although every company registered under the Act should have the word 'Limited' at the end of its Name, the Central

Government may permit certain associations to drop the word, if they satisfy certain conditions.

(2) **Situation Clause**: This clause specifies the State in which the Registered Office of the Company is to be situated. At this stage, it is not necessary to state the name of the city or town, where the Company has its Registered Office. But within 30 days of Incorporation or Commencement of Business, the exact location of the Registered Office in the State must be communicated to the Registrar.

(3) **Objects Clause**: This is the most important of all the clauses contained in the Memorandum. The purpose for which the proposed Company is formed must be clearly defined in this clause. The Company can have any object. The only restriction is that it should not go against the law of the land or infringe any of the provisions of the Companies Act.

As for the shareholders, enumeration of the objects enables them to know the purposes to which the Company will apply their money. As for the creditors since the scope of the activities is clearly stated, a Company cannot spend its funds on any undefined project. This gives them a feeling of security.

According to the Companies Act, the Objects Clause of a Company to be registered after the amendment must be divided into two sub-clauses. The first sub-clause must specify the *main* objects as well as those incidental or ancillary to the attainment of the main objects. The second one must state the other objects (not included in the first one).

We have already stated that the objects Clause limits the scope and powers of the Company. Any act which is outside the scope set out in the Objects Clause is ultra vires (beyond the powers of) the Company.

An ultra vires act is not binding on a Company. Even a subsequent ratification of the act, by all the shareholders, cannot have the effect of revalidating it. It must be understood that only if an act is ultra vires the Company, it is null and

void; if it is ultra vires the Directors only or the Articles only, it can be validated subsequently.

(4) **Liability Clause:** This Clause states that the liability of the members is limited. It may be limited either by Shares or by Guarantee. In the former case, a shareholder shall not be called upon to pay anything more than the nominal value of his shares. If the full face value of the shares is already paid up, the member is not liable any further. In other words, the liability of members is restricted to the amount remaining unpaid on the shares.

In the case of Companies, 'Limited by Guarantee', the liability of a member is limited to the amount he has undertaken to contribute to the assets of the Company in the event of its winding up. If the Guarantee Company has a share capital also, the liability of members in such a Company is limited to the unpaid amount of the shares, in addition to the amount guaranteed.

An unlimited Company need not have this clauses in its Memorandum.

(5) **Capital Clause:** The amount of Share Capital with which the Company is to be registered and its division into shares of a fixed amount must be stated in this clause. In the case of an unlimited Company, this clause need not be inserted.

(6) **Association Clause or Subscription Clause:** The names of persons who have agreed to subscribe to the Memorandum must be mentioned in this clause together with their occupations and addresses. Each subscriber to the Memorandum must take not less than one share in the Company and must write opposite to his name, the number of shares he has agreed to take.

Subscribers must then sign the Memorandum in the presence of at least one witness who attests their signatures.

Apart from this, they also declare their desire to form a Company in pursuance of the Memorandum.

**Whether Memorandum is Alterable?**

Memorandum of Association which sets out the constitution of a Company is a document of great importance. Though its alteration is possible, it is subject to certain severe restrictions. Clauses such as Name, Situation, Objects, Liability and Capital are considered to be the conditions contained in it. These clauses can be altered only to the extent to which and the mode according to which express provision has been made in the Act. The intention is to prevent an easy alteration with a view to protecting the interests of the creditors and shareholders.

**Change of Name**

A Company can change its name by passing a Special Resolution and getting the approval of the Central Government in writing.

**Change of Registered Office**

A Company has no difficulty in changing its Registered Office from one place to another within the same town or city; it has only to give notice of such a change to the Registrar.

For shifting its Registered Office from one place to another within the same state, Special Resolution has to be passed.

But change of its Registered Office from one State to another necessitates alteration in the Memorandum itself. In addition to passing a Special Resolution, the confirmation of the Company Law Board is also to be obtained to effect this alteration. A certified copy of the order confirming the alteration must be filed with the Registrar of each of the States.

**Change of Objects**

As for the procedure, it is the same as explained above for alteration of a Situation Clause. That is, a Company has to pass a Special Resolution at a General Meeting of the Company. It will not take effect until it is confirmed by the Company Law Board. The Company Law Board will confirm the alteration only for any of the following purposes:

(i) To carry on its business more economically or more efficiently;

(ii) To attain its main purpose by new or improved means;

(iii) To enlarge or change the local area of its operations;

(iv) To carry on some business which can be conveniently combined with the business of the company;

(v) To restrict or give up any of its present objects;

(vi) To sell or dispose of the whole or any part of the undertaking of the Company;

(vii) To amalgamate with any other Company.

A certified copy of the order of the Company Law Board together with a printed copy of the altered Memorandum must be filed with the Registrar within three months of the confirmation.

**Change of Capital Clause**

The Articles of Association. must first give powers to alter the Capital Clause in the Memorandum. Either for increasing its Share Capital beyond the Authorised Capital or for reorganising its capital structure, the Company must pass a resolution (Ordinary or Special as prescribed by the Articles) and file a copy of it with the Registrar. For reducing its Share Capital, the Company has to pass a Special Resolution and to get it confirmed by the Court.

**Change of Liability Clause**

No alteration of this clause is possible so as to make the 'Limited Liability' of its members 'unlimited'. However if the Articles authorise a Company, it can by Special Resolution alter its Memorandum with a view to rendering unlimited, the liability of its Directors or Manager. But such alteration becomes effective only on the expiry of the existing term of office of any of the above managerial personnel, unless he has given his consent to it.

## ARTICLES OF ASSOCIATION

Articles of Association is the second important document which a Company should have. The Articles lay down the manner in which the business of the Company is to be conducted. They are its Bye-laws governing the internal management of its affairs.

**Registration of Articles**

The following Companies must frame separate Articles of their own :

(i) Unlimited Companies

(ii) Companies Limited by Guarantee

(iii) Private Companies Limited by Shares.

Their articles must be filed with the Registrar along with the Memorandum, signed by the subscribers of the Memorandum. In the case of a Public Limited Company, registration of Articles is not compulsory.

**Table A**

Table A in Schedule I to the Companies Act contains model regulations for the management of a Company, Limited by Shares. If a Public Company does not register its own Articles, it is deemed to have adopted Table A. Even in the case of Companies which have registered their Articles, regulations in Table A will automatically apply to the extent they are not excluded or modified by their Articles.

**Form and Signature of Articles**

The Articles must be

(i) printed;

(ii) divided into paragraphs, numbered consecutively; and

(iii) signed by each subscriber of the Memorandum in the presence of at least one witness who should also attest the signature.

The addresses and occupations of the signatories as well as the witnesses must also be given.

In the case of an Unlimited Company, the Articles should state the number of members with which the Company is to be registered; if it has a Share Capital, the amount of Share Capital and in the case of a Guarantee Company, the number of members with which the Company is to be registered, must be stated.

In the case of a Private Company, having a share capital, the Articles must contain provisions

(i) restricting the right of transfer of its shares;

(ii) limiting the number of its members to fifty excluding the present or former employees of the company, who are at the same time its shareholders.

(iii) prohibiting any invitation to the public to subscribe for its shares or debentures.

**Contents**

Articles usually contain regulations regarding the following matters :

(i) If Table A is to be excluded, an Article for its exclusion.

(ii) Adoption of preliminary contracts.

(iii) Shares, Calls, Forfeiture, Transfer, Transmission of Shares, Conversion of shares into Stock, Share Warrants.

(iv) Share Capital.

(v) Meetings, Notices, Proxies, Polls, Voting Procedure.

(vi) Directors, their remuneration, their qualifications, appointments etc.,

(vii) Accounts, Audit etc.,

(viii) Dividends, Reserves, Capitalisation of Profits;

(ix) Winding up.

Certain powers cannot be exercised by a Company unless its Articles give it the power to do so. Some such instances are:

(i) Issue of Redeemable Preference Shares;

(ii) Raising of its Share Capital or reorganising its capital structure;

(iii) Reduction of its Share Capital;

(iv) Rendering unlimited, the liability of its directors.

Hence Articles of Association of a Company must contain provisions for exercising these powers also.

**Articles in Relation to Memorandum**

Articles are subordinate to the Memorandum. They should not go against any of the provisions of the Companies Act or anything contained in the Memorandum. Any act in excess of the scope of the Memorandum is in capable of ratification and is absolutely invalid and unenforceable, whereas anything done in contravention of the Articles is only irregular and can be ratified by the shareholders.

A Company can enforce the Articles against any member. Similarly a member is entitled to sue the Company for any breach of its Articles which will affect his rights as a member. But a member has no right to sue another member.

**Alterations of Articles**

Every Company has a power to alter its Articles. This is subject to the following conditions :

(1) Special Resolution must be passed.

(2) Alteration must not offend the provision of the Act or the condition contained in the Memorandum.

(3) Alteration made to convert a Public Company into a Private Company will not take effect unless approved by the Central Government.

(4) An alteration must not require a member to buy more shares or enhance his liability without his consent.

## PROSPECTUS

When a Private Company is formed, necessary capital to work the Company is secured by private arrangement. It is by its very constitution prohibited from approaching the general public for participation in its Share Capital. The case of a Public Company is quite contrary in that the public at large is invited to buy its shares. Though it is also allowed to raise its capital through private contacts; by for the largest number of Public Companies appeal to the public for this purpose by means of 'Prospectus'.

### Definition

Section 2 (36) of the Companies Act defines the term 'Prospectus' as 'any document prescribed or issued as a Prospectus and includes any Notice, Circular, Advertisement or other document inviting deposits from the public for the subscription or purchase of any shares in, or debentures of, a Body Corporate".

Any advertisement issued by a Company calling for offers from the public to buy its Shares or Debentures of a Company is a Prospectus. It is an open invitation extended to the public at large.

Prospectus, therefore, is a document designed in such a way as to persuade the public to buy Shares or Debentures of the Company. It must contain all relevant information about the Company, its objects, future prospects, its managerial personnel—in short, particulars which will enable a person to decide whether to buy its shares or not.

### Registration of Prospectus

As stated earlier, every Public Limited Company, having a share capital, must issue a Prospectus. It must be dated and signed by every person named therein as a Director. A copy of it must be delivered to the Registrar before its issue to the public. It must be accompanied by certain documents.

A Prospectus must also state that its copy together with the necessary documents have been delivered to the Registrar. It must be issued within ninety days of its registration,

**Matters to be specified in a Prospectus**

(1) The main objects of the Company.

(2) Particulars about the signatories to the Memorandum and Shares subscribed by them.

(3) The number and classes of Shares and the rights of each class of Shareholders.

(4) The number of Redeemable Preference Shares to be issued with the date of redemption, if fixed; The proposed method of redemption must also be stated.

(5) Qualification Shares of Directors.

(6) Remuneration of Directors.

(7) Particulars regarding Directors, Managing Directors and Managers.

(8) Contents of the Articles or a copy of appointment order of Managing Director or Manager, their remuneration and compensation payable to them for loss of office.

(9) Where shares are offered to the public, details as to the amount of Minimum Subscription.

(10) The time of the opening of Subscription List.

(11) Application and Allotment money payable and details about previous allotments.

(12) Names of under-writers, if any.

(13) The rate of under-writing commission.

(14) Preliminary Expenses.

(15) Names and addresses of Auditors of the Company.

(16) Where the Share Capital is divided into different classes of shares, the voting rights, rights in respect of capital and dividend attached to different classes of shareholders.

(17) Details of restrictions, if any, imposed by Articles on member's right to attend, speak or vote at meetings or

on the right to transfer shares or restriction on the Directors' powers of management.

(18) In the case of an existing Company, the length of time during which the business has been carried on.

(19) Particulars of any Capitalisation of profits and Reserves.

(20) Reasonable time and place at which the copies of Balance Sheets and Profit & Loss Accounts can be inspected.

**Correctness of Statement in the Prospectus:** The investing public is induced to buy Shares or Debentures in the Company on the strength of the Prospectus. Hence the promoters will try to paint as rosy a picture as possible. On account of suppression of certain material facts and on account of publication of flattering descriptions not borne out by facts, public may be misled to believe that very great advantages would accrue to them, if they subscribe to the shares of the Company. In as much as civil as well as criminal liability lie against those who issue misleading Prospectus,it must be prepared with scrupulous accuracy.

## (c) Shares

According to Section 2(46) of the Companies Act, "Share" means "share in the share capital of a Company and includes Stock except where a distinction between Stock and Shares is expressed or implied". But this definition does not bring out the clear meaning of the term.

We all know that the capital of a Company is divided into units of a fixed denomination. These units are called Shares. They carry with them certain rights. Share is held to denote the right to participate in the profits of a Company while it is a going concern and the right to participate in the assets of a

Company, when it is wound up. It is "the interest of a shareholder in the Company measured by a sum of money"

Each share, in a Company having a Share Capital, must be numbered so as to distinguish it from another. A Company must issue a Certificate of Share under its Common Seal specifying the shares held by a member. This certificate is the evidence of the title of the member to such rights.

**Kinds of Shares**

The following are the most common classes of Shares:

(i) Preference Shares

(ii) Equity Shares (Ordinary Shares)

(iii) Deferred Shares or Founders' Shares.

A Public Company, limited by shares, can issue only the first two types of shares.

**Preference Shares**

These shares must fulfil both the following requirements:

(i) A preferential right in the matter of dividend.

(ii) A preferential right in the repayment of capital on winding up.

As respects dividend, a fixed amount, usually calculated as a fixed percentage of the nominal value of the shares, is to be paid before Equity Shareholders are paid anything. Thus it becomes clear that the rate does not vary with profits every year. The same amount of dividend is paid irrespective of the level of profit. On the winding up of the Company, again such shareholders are shown preference. Before anything is refunded to other types of Shareholders, the amount paid up on Prefererce Shares will have to be returned.

**Participating Preference Shares:** We have stated that Preference Shareholders are entitled to get a fixed rate of dividend. There may remain surplus profits after payment of

dividend to Preference Shareholders and Equity Shareholders. The question is whether Preference Shares are entitled to share in the surplus. If they are so entitled by virtue of the Memorandum or Articles or the terms of issue, they are known as "Participating Preference Shares."

Similarly on a winding up, after returning the entire Preference and Equity Share Capital, there may be surplus. If Preference Shareholders are entitled to participate in the surplus assets also, they are known as Participating Preference shares.

It must be understood that conferment of a right to participate in the surplus profit does not imply the conferment of the right to participate in the surplus assets also or vice versa.

**Cumulative Preference Shares :** Even in the case of Preference Shares, their holders are entitled to the fixed rate of dividend only when there are sufficient profits for such distribution and only after recommendation by the Board, and declaration of dividend in a Company Meeting. It follows that, in case, no profits are available in a year, even Preference Shareholders have to go without any dividend. But if such arrears of dividend unpaid during a year are to be paid out of the profits of subsequent years, the Preference Shares are said to be 'Cumulative Preference Shares.' Unpaid dividends accumulate and in the year of ample profits, they have to be cleared first.

In the absense of any specific provision to the contrary in the Articles or Memorandum, Preference Shares are presumed to be Cumulative.

**Non-Cumulative Preference Shares :** If owing to absence of profits or inadequacy of profits, dividend is not declared and such arrears of dividend cannot be carried forward to subsequent years, the Preference Shares are said to be Non-cumulative. In other words, dividends of one year cannot be paid out of the profits of subsequent years. The right to receive arrears of dividend is normally inherent in a Preference Share. This right may be expressly denied by the Memorandum or

Articles, in which case the Preference Shares become Non-Cumulative.

**Redeemable Preference Shares :** Though a Company cannot buy its own shares during its life-time, it may issue Redeemable Preference Shares. As Preference Shares, they carry a fixed rate of dividend in preference to other types of Shareholders and as Redeemable Shares, they can be bought back by the Company.

Redeemable Preference Shares can be redeemed subject to certain conditions at a fixed date or after the lapse of a particular period or at the option of the issuing Company.

**Equity Shares**

Shares which do not have any preferential treatment as respects Dividend and return of Share Capital are known as Equity Shares (Ordinary Shares). The rate of dividend, unlike on Preference Shares, changes every year. It will rise or fall as the profit is high or low. There is no question of paying accumulated arrear dividend in subsequent years as their right to receive it lapses every year. Only if profit remains after paying the fixed dividend to Preference Shareholders, Equity Shareholders will get any. Similarly on winding up, the turn of Equity Shareholders comes only after the Preference Shareholders are paid back their entire capital. In short, the features of Equity Shares are :

(1) Dividend is payable on these shares only after payment of dividend on Preference Shares.

(2) At the time of liquidation, Equity Capital is returnable only after repayment of Preference Capital.

(3) These shares are always Non-cumulative.

(4) Dividend is not a fixed amount.

(5) Equity Shareholders are entitled to vote on all resolutions.

**Deferred Shares or Founders' Shares**

A Public Company in India cannot issue Deferred Shares, while Private Companies are allowed to do so. As the very name implies,dividend will be paid to the holders of these shares subsequent to Equity Shareholders.

Promoters of a Private Company generally subscribe to this type of shares. That is why they are also known as Founders' Shares.

**Allotment of Shares**

The investing public, when they apply for shares, are said to make offers to the company for purchasing shares. It is for the Company to accept these offers or not. 'Allotment of Shares' is exactly the process of accepting such offers. There are many statutory restrictions on allotment of shares.

A Return as to Allotment of Shares must be filed with the Registrar within thirty days of allotment of shares.

An Allotment made in contravention of the statutory restrictions is irregular allotment. An irregular allotment is voidable.

**Share Certificate**

The Company must deliver to every allottee of shares a document known as 'Share Certificate'. Every certificate must be issued under the Common Seal of the Company. It must specify the name of the shareholder and the distinctive numbers of the shares. The nominal value as well as amount paid up must also be shown. It must be signed by at least two Directors, and the Secretary or any person appointed by the Board.

A Share Certificate is an evidence to title. The person named therein is the owner of the shares specified and the shares are paid upto the amount stated in the Certificate.

**Calls**

It is obvious that members of a Company have to pay the full nominal value of the Shares they hold and that by and large the full value of the shares is paid only in instalments.

Let us take a concrete example. The Nominal Value of a share is Rs. 10, Rs. 2 being payable along with Application, Rs. 2 on Allotment and the balance as and when required in one or two instalments. The sum of Rs. 2 to be paid along with Application and the further sum of Rs. 2 payable on Allotment are not 'Calls'. Only the balance of Rs. 6 payable in one or two instalments thereafter is known as 'Call Money'.

After collecting the Application and Allotment money, the Company may call upon the shareholders as and when required to pay the balance amonnt. Thus 'Call' refers to the demand made by a Company on the shareholders to pay the whole or a portion of the sum remaining unpaid on shares. This debt due by the shareholders on their shares is liquidated by paying the call money.

**Forfeiture of Shares**

If the Articles so empower, the Board may, by passing resolution, forfeit shares for non-payment of the Call Money, of course, after giving due notice in this regard. On forfeiture, the shareholder ceases to be a member of the Company. The Company can, however, re-issue the shares forfeited.

**Shares at a Premium.**

A Company can issue shares 'At a premium', i.e., at a higher price than the nominal value of the Share. The premium received cannot be treated as profit and hence cannot be used for payment of dividend. It should be carried to a separate account called the "Share Premium Account". This can be used only for purposes mentioned in the Act such as for writing off Preliminary Expenses, Discount on Issue of Shares, Under-writing Commission etc.

**Shares at a Discount**

The Companies Act permits the issue of shares 'at a discount', i.e., for a price lower than the nominal value of the Share. But certain strict conditions, as mentioned below, have been laid down for such an issue:

(i) A Company cannot issue shares for the first time at a discount. It only means that a Company is permitted to issue shares at a discount of a class already issued.

(ii) A resolution authorising such an issue must have been passed by the Company in General Meeting and sanctioned by the Company Law Board.

(iii) The resolution should specify the maximum rate of discount. Ordinarily this must not exceed ten per cent

(iv) At least one year should have elapsed since the date on which the Company was entitled to commence business.

(v) Such shares must be issued within two months of getting the sanction of the Company Law Board in this regard.

**Register of Members**

Every company must keep a Register of its Members and enter therein the requisite particulars.

**Stock**

According to the Companies Act, Share includes Stock. A Company can convert its fully paid up shares into Stock and re-convert its stock into shares of any denomination.

A company, however, cannot issue Stock as such; it can only convert its shares into stock provided its Articles permit such a step.

Stock represents the consolidated amount of the fully paid up shares of the Company. For cxample, a person holds 10 shares of Rs. 10 each, fully paid. After conversion of Shares into Stock, he is said to be holding 'Stock worth Rs. 100.' It is no longer divided into units of a fixed donomination. A Stock-holder can transfer any fraction of the Stock he holds. The Register of Members obviously cannot show the distinctive numbers of Stock held by each member; (Stocks do not bear any

distinctive number); it can only indicate how much Stock is held by each Stock-holder.

**Share Warrant**

A Share Warrant is a document issued by a Public Limited Company. It states that the bearer of the Warrant is entitled to the Shares specified therein. It can be transferred by delivery like any other negotiable instrument. Thus it is like a Bearer Share Certificate.

Dividend coupons are attached thereto for payment of future dividend on these shares. Only fully paid-up shares can be converted into Share Warrants with the prior approval of the Central Government.

## (d) Debentures

A trading company has an inherent power to borrow. But a non-trading company can borrow if its Memorandum confers such a power. One of the usual methods resorted to by a Company for borrowing huge amounts is by issuing Debentures.

**What is a Debenture?**

The Companies Act does not define this term precisely. **Chitty**, J. defined it thus :

> "Debenture means a document which either creates a debt or acknowledges it."

From the above definition, it becomes clear that a Debenture is a document containing an acknowledgement of indebtedness. When a Company issues Debentures, it is only raising a loan. Therefore interest is payable at stated intervals, usually half-yearly till the Debentures are redeemed.

**Distinction between Shares and Debentures**

(i) A Debenture holder is a creditor of a Company and not its member, whereas a Shareholder is a member of the Company and enjoys all the rights of membership.

(ii) A Shareholder will get dividend only out of profits of the Company. He has to forego it during years of losses. A Debenture holder, on the other hand. will receive his interest periodically and the availability of profit is immaterial.

(iii) Rate of interest payable to a Debenture holder is fixed whereas dividend payable on Equity Shares varies with profit. During years of prosperity, the Equity Shareholders will get a very high rate of dividend and thus they are amply compensated for the sacrifice they make during years of adversity.

(iv) As members of the Company, Share holders have a right to attend and vote at the meeting of its members. Thus, the ultimate control of the Company's affairs is in their hands. Debenture holders, being its mere creditors, have no such rights.

(v) Further, a Share holder, by getting elected as a Director gets direct powers of management. A Debenture holder is denied this opportunity.

(vi) The amount paid up on Shares will not be refunded to its holder during the life time of the Company. The only exception is with regard to the Redeemable Preference Shares which have to be redeemed even when the Company is a going concern according to the terms of their issue. But Debentures are to be repaid after a specified period or according to the terms of their issue.

(vii) Even at the time of winding up, the claims of Debenture holders must be first met before returning any part of its Share Capital to either its Preference or Equity Share holders.

**Statutory Provisions Regarding Issue of Debentures**

Procedure for issue, allotment, transfer etc., of Debentures is almost the same as that for Shares. Subject to such restrictions as may be laid down in the Articles, the power to issue Debentures can be exercised only by the Board of Directors.

**Register of Debenture Holders**

Every Company should keep a Register of its Debenture Holders.

**Kinds of Debentures**

Debentures are of different kinds based on

(i) transferability,

(ii) security,

and (iii) redeemability.

**(i) Based on Transferability**

(a) **Registered Debentures:** We have already seen that a Company should keep a Register of Debenture Holders, where particulars of Debenture holdings are recorded. The name of the holder of Debentures is mentioned in the Debenture Certificate and is also recorded in the Register of Debentures. Such a Debenture holder is known as a Registered Debenture Holder and such Debentures are called Registered Debentures. Interest as well as the principal amount will be paid only to the Registered Holders. Registered Debentures, like Shares, can be transferred, only by executing a proper instrument of transfer. Thus all transfers have to be registered with the Company.

(b) **Bearer Debentures:** Debentures payable to bearer are known as Bearer Debentures. Coupons are attached thereto for payment of interest. Interest as well as the principal amount is paid to the holder without any reference as to his identity. Particulars of holders of these debentures are not entered in the Register of Debentures and consequently Bearer Debentures can be transferred by mere delivery. Transfers are not at all registered with the Company. However, the holder of a Bearer Debenture can have his name entered on the Register of Debenture Holders thus converting a Bearer Debenture into a Registered Debenture by applying for it and paying a nominal fee.

**(ii) Based on Security**

(a) **Simple Debentures:** They are also called Naked Debentures or unsecured Debentures. As the description itself suggests, no security is offered to such Debenture holders either for payment of interest or for return of the principal amount. They are in the position of unsecured creditors and rank as such in a winding up.

(b) **Secured or Mortgage Debentures:** These debentures are secured by a charge or mortgage on the assets of the Company. If specific assets such as land and buildings are mortgaged, it is known as a 'Fixed Charge.' On the other hand, if assets, existing or future, which keep on changing from time to time in the ordinary course of business are charged, it is known as 'Floating Charge'. In case of default in the payment of interest or at the time of winding up, these Debenture holders have got assets to fall back upon.

**(iii) Based on Redeemability**

(a) **Redeemable Debentures:** Such Debentures as have to be paid off on a specified date or on expiry of a stated period are known as 'Redeemable Debentures'. The process of paying back the Debenture holders and getting the assets released from the charge is known an 'Redemption'.

(b) **Irredeemable Debentures:** They are also known as 'Perpetual Debentures'. They are not redeemable during the life-time of the Company. But the Company can redeem them as and when it pleases. The point to note is that the right to demand repayment, when the Company is a going concern, is denied to such Debenture holders.

However, when the Company defaults in the payment of interest, these Debentures become redeemable.

Whether redeemable or irredeemable, Debentures become automatically repayable when the Company goes into liquidation.

## (e) Directors

While discussing the features of a Company form of organisation, we have already stated that there is separation of ownership from control. A very large number of shareholders scattered over a wide area cannot be expected to take an active interest in the management of the Company. Apart from the

numerical largeness of members, the complexity of modern business is also a problem insurmountable for the ordinary run of people. Further, Shares being transferable, the ever changing membership can hardly give a clear, coherent direction to the affairs of the business. Hence we find in a Company form of business organisation a divorce between ownership and control. It is true that its members have a financial stake in the business; yet they do not have powers to manage its affairs.

All powers of management are vested in a Board of Directors, directors being elected by the members from among themselves.

The Directors of a Company collectively are referred to as the 'Board of Directors' or the 'Board'.

It is obvious that though a Company is said to be a person in the eyes of law, it can conduct its business only through human agency. It is the Board of Directors which does this work. The affairs of a Company are managed, contracts finalised, and the Company looked after by the Board. Directors are thus the persons who direct and supervise the affairs of a Company and protect and promote its interests.

The growth and prosperity of a Company undoubtedly depends on the efficiency, foresight, competence and honesty of its directors.

**Who can be a Director?:** Only an individual can be appointed director of a Company. It means that a Partnership firm or a an Association or a Campany cannot serve as a director.

**Minimum Number of Directors:** We have already seen that every Public Company shall have at least three directors and a Private Company at least two. The Articles of a Company can provide for a larger number. A Company can increase or reduce the number of its directors fixed by its Articles.

**Appointment of Directors**

**(1) Appointment of First Directors:** The first directors are named in the Articles. If not, all the subscribers of the Memorandum, who are individuals, will be deemed to be the Company's first directors. They will hold office until the appointment of directors at the First Annual General Meeting of the Company.

**(2) Appointment by Company at General Meeting:** Articles may provide for retirement of all its directors at every Annual General Meeting. If not, at least two-thirds of the total number of directors shall be persons who will be liable to retire by rotation. One third of such directors shall retire from office every year.

For example in a Company there are nine directors; at least six of them are liable to retire by rotation; Of these six directors, two have to retire every year.

**Re-appointment:** Vacancies thus created may be filled at the same Meeting. Retiring directors are eligible for re-appointment. Thus the Company may appoint either the retiring directors themselves or some other persons.

**(3) Appointment by Board:**

(a) **Casual Vacancy:** A casual vacancy may arise because of death, resignation, etc. of a director. The Board of Directors are given power to fill it at a Meeting of the Board.

(b) **Appointment by Board - Additional Directors (Sec. 260)**

If the Articles empower, the Board can appoint additional directors. The total number of directors including the additional directors should not exceed the maximum fixed by the Articles.

The additional directors will hold office only upto the date of the next Annual General Meeting.

(c) **Appointment by Board - Alternate Director (Sec. 313)**

The Board can appoint under Certain circumst tances an alternate director in the place of an original director during the latter's absence from the State in which Meetings of the Board are ordinarily held.

The alternate director should vacate office if and when the orignal director returns to the State.

(4) **Appointment by Central Government:** The Central Government may appoint such number of directors as it thinks fit to safeguard the interests of the Company or its Shareholders or the public interest.

They will hold office for three years; they are not liable to retire by rotation and they need not hold any Qualification Shares.

**Qualifications of Directors:** The Act does not prescribe any qualification. However, the Articles may lay down 'Share Qualification' for a director. Share Qualification refers to the minimum number of shares prescribed by the Articles which every director should hold. The nominal value of the Qualification Shares shall not exceed five thousand rupees or the nominal value of one share where it exceeds five thousand rupees.

**Removal of Directors**

(i) **Removal by the Company (Shareholders):** A Company can remove a director before the expiry of his term of office by an Ordinary Resolution. But a special notice is required in this connection.

(ii) **Removal by Court:** If an application is made to the Court for relief in cases of oppression and mismanagement, the Court has power to remove a director.

(iii) **Removal by Central Government:** The Central Government may, under certain circumstances, remove a director.

**Powers of Directors**

**General Powers of the Board:** The Board of Directors of a Company has generally the power to do all acts which the Company can do,

However, the Board cannot do such acts which the Company has to do only in General Meetings.

**Specific Powers**

The Board of Directors only can exercise the following powers :

(1) Appointment of the first Auditors and fixation of their remuneration.

(2) Filling up of any casual vacancy of an Auditor, not caused by resignation.

(3) Appointment of Additional Directors.

(4) Appointment of Alternate Directors.

(5) Contribution to National Defence Fund.

(6) Making of Calls on Shares.

(7) Issue of Debentures.

(8) Borrowing otherwise than on Debentures.

(9) Investing the funds of the Company.

(10) Filling up of the casual vacancy of a Director.

**Restrictions on the powers of the Board**

The following powers can be exercised by the Board after obtaining approval in the Generel Meeting :

(i) to sell, lease or dispose of the Company's undertaking;

(ii) to extend time for the repayment of a debt due by a Director;

(iii) to borrow money above a certain level ;

(iv) to contribute to charitable or other funds above a certain level;

(v) to appoint a Sole-selling Agent.

**Duties of Directors**

**General :** We have already stated the duties of Directors in general terms. They have to exercise all the powers vested in them in good faith and in the interests of the Company. They should not sacrifice the Company's interests for promoting their own.

They should follow prudent commercial practice; they should not conduct the affairs of the Company in a manner oppressive to any member of the Company or in a manner prejudicial to the interests of the Company.

**Statutory Duties :** Some of the important Statutory Duties of Directors are :

(1) to sign a prospectus and to deliver it to the Registrar for registration before its issue to the public;

(2) to see that the Prospectus does not contain any untrue or misleading statements;

(3) to keep deposited in a Scheduled Bank, the Share Application money till its disposal;

(4) not to allot shares unless Minimum Subscription is received;

(5) to pay the amount due on Application and Allotment on their shares to get the Certificate of Commencement of Business;

(6) to prepare a Statutory Report and send it to every member;

(7) to certify the Statutory Report and file it with the Registrar.

(8) to call an Extraordinary General Meeting of the Company on the requisition of the prescribed number of members of the Company;

(9) to keep proper Books of Accounts;

(10) to lay before every Annual General Meeting, a Balance Sheet and a Profit and Loss Account;

(11) to attach to every Balance Sheet laid before the Company in General Meeting, a report by the Board on the working of the Company during the financial year;

(12) not to contribute any amount to any political party or to anybody for any political purpose.

**Liabilities of Directors**

Ordinarily Directors are not liable for acts done by them so long as they do not exceed their authority. We have already seen that one of the important duties of Directors is to act in good faith. If the Directors use their powers and position for their personal gain, they become liable for breach of trust. They have to return to the company any secret profit made by them by using their position as Directors.

Further, they have to discharge their duties with reasonable care and diligence. If because of their gross negligence, Company suffers loss, they have to make good the loss.

**Criminal Liability**

The Directors are criminally liable for authorising the issue of an untrue Prospectus, for making irregular allotment and for certain other acts.

**Directors with Unlimited Liability**

Even in a Limited Company, the liability of any Director or all the Directors or Manager may be unlimited if the Memorandum so prescribes.

**Remuneration**

Directors are entitled to remuneration. It may take the form of sitting fee, periodical remuneration or commission. A ceiling on it has been fixed by the Act.

**Management**

The very fact that a person can be a Director of twenty companies makes it clear that he is not expected to devote his continuous attention to the conduct of the business of any one

Company. Members of the Board are usually persons having financial interests in so many other Companies; the direction of affairs of other Companies too demands their equal attention. In view of this, they may at best lay down the broad business policy and may attend only to urgent problems and statutory duties. The day-to-day administration is left in the hands of a particular Director, designated usually as Managing Director. Management of a company, at present, can be entrusted to either a Managing Director or a Manager. It cannot have both.

## (f) Managing Director

Managing Director is a Director entrusted with substantial powers of management. The substantial powers do not include routine administrative powers. Only an individual can be a Managing Director. He works under the supervision, control and direction of the Board.

**Appointment**

The Articles usually contain provisions for the appointment of a Managing Director. The appointment of a person as Managing Director for the first time requires the approval of the Central Government. A person can be, a Managing Director in two companies only.

A person cannot be appointed as Managing Director of a Company for a period exceeding five years at a time. But he can be re-appointed from time to time for a period not exceeding five years on each occasion. Amendment of any provision relating to the appointment or re-appointment of a Managing or Whole-time Director shall be invalid without the approval of the Central Government.

**Remuneration**

A Managing or Whole-time Director can be paid remune ration either by way of a monthly payment or as a specified

per centage of the net profits of the Company or by both the methods.

It should not exceed

(i) five per cent of the net profits for one such director and

(ii) If there is more than one such director, ten per cent of the net profits for all of them put together.

**Increase in Remuneration**

In the case of a Public Company, remuneration payable to any director including Managing or Whole-time Director cannot be increased without the approval of the Central Government.

**Manager**

Manager is an individual entrusted with the management of the whole or substantially the whole of the affairs of a Company. He has to act subject to the superintendence, control and direction of the Board of Directors. He can be a Director or any other person.

A person can be the manager of two companies only. But the Board of Directors of the Second Company which appoints him must approve the appointment by passing a resolution unanimously.

Remuneration payable to a Manager can take the form of a monthly payment or by way of a specific percentage of the net profits of the Company. It should not exceed five per cent of the profits.

Appointment or reappointment of a Manager requires approval of the Central Government. His remuneration cannot be raised without the approval of the Central Government. He can be appointed for a term not exceding five years at a time and he can be re-appointed from time to time similarly.

**Over-all Managerial Remuneration**

A Public Company can pay to all its managerial personnel (Directors, Managing Directors, Whole-time Directors and Manager) a remuneration not exceeding 11% of its net profits.

## (g) Company Secretary

As in any other field, Secretary of a Company occupies a position of pivotal importance; he is the eyes and ears of a Company.

Secretary has to do what his directors want him to do. It is his duty to execute the resolutions passed by the Board. He does not have authority to enter into contracts on behalf of the Company unless the Articles confer upon him such powers.

**Qualifications**

**General**: Since a Secretary has to perform a wide variety of duties, he should be well qualified. Many a time he may have to advise directors on matters pertaining to the provisions of the Companies Act. Since it is the primary duty of a Secretary to arrange for the Board Meeting, Share holders' Annual General Meeting etc., he should be fully conversant with all the provisions of the Act. He should also have a working knowledge of various other laws relating to Contract Act, Sale of Goods Act, Negotiable Instruments Act, Patents and Copyrights Act, the Workmen's Compensation Act and other Labour Laws. Thus in addition to a high general educational qualification, qualification in law will be an added advantage.

A practical knowledge of the best systems of Filing, Indexing, Labour saving appliances, Methods of recruiting office staff, Allocation of work etc., will make for a high degree of efficiency. Thus training in Office Management will add to his qualifications.

He should have a basic knowledge of Accountancy, Income Tax Law, Sales Tax Act, Stamps Act etc. Knowledge of the Law

and Practice of Banking and Industrial Finance is also essential. Thus qualifiication in Commerce will prove to be of invaluable help to him in the discharge of his duties.

Further, a Secretary should have good command over language. He is mostly concerned with correspondence work and preparation of reports on varied matters. He should be good at drafting.

**Statutory Qualifications:** Every Company having a paid-up Share Capital of Rs. 25 lakhs or more should have a Secretary who holds membership of the Institute of Company Secretaries of India. For other Companies, Degree in Law or Membership of the Institute of Chartered Accountants of India or Membership of the Institute of Cost and Works Accountants of India or Post-graduate Degree in Commerce are the other recognised qualifications.

**Appointment**

The first Secretary of a Company is usually named in the Articles. Or else promoters may appoint him to assist them in their preliminary work connected with the formation of the Company.

It is the Board which appoints a Secretary on regular basis. Terms and conditions of appointment such as pay and allowances, other perquisites etc., must be spelt out in clear terms.

Similarly it is the Board which can remove him from service. A Director also can be appointed as Secretary of the Company.

**Duties of a Company Secretary**

Though the Compaies Act has not specified the duties of a Secretary, he is recognised as an officer of importance in the Company form of organisation. Wherever the Act has imposed penalties on its officers for non-compliance with its provisions, the Secretary, as a principal officer, has to face them. He has to perform duties of a varied nature. They can be broadly classified as follows:

(i) **Statutory Duties**

(ii) **Duties to Directors**

(iii) **Duties to Shareholders**

(iv) **Duties to the Public**

(v) **Duties as Office Executive.**

(1) **Statutory Duties:** The Secretary of a Company must ensure that the provisions of theCompanies Act are strictly followed in all matters. He is responsible for keeping certain books and registers at the Registered Office of the Company. Various documents and returns have to be filed with the Registrar of Companies right from the formation of the Company till its liquidation. It is the duty of the Secretary to deliver to the Registrar in time various Statements and Statistical Returns.

Besides the Companies Act, he has to observe formalities imposed by other Acts too.

(2) **Duties to Directors:** A Company Secretary, though its principal officer, is only an employee of the Company. It is his duty to carry out the instructions of the Board; he can exercise only such powers as are delegated to him.

He can be of immense help to the directors in formulating Policies.

It is the duty of the Secretary to arrange for the periodical holding of the meeting of the Board of Directors. In consultation with the Chairman, he has to fix the date, time, and place of the meeting, to prepare the Agenda, to send Notices and to record the proceedings of the meetings.

(3) **Duties to Shareholders:** Shareholders, whatever be the extent of their shareholdings, are the real owners of the Company. Secretary may have frequent occasions to correspond with them; he should be polite and courteous and should keep them satisfied with his replies. While he can give them necessary information and particulars, anything of a confidential nature should not be leaked out

The Secretary, as a connecting link between the Board and the Shareholders, communicates the decision of the Board to them. He has to make all necessary arrangements for the conduct of the Annual General Meeting in such a way that Shareholders do not complain.

(4) **Duties to the Public :** It is the Secretary who links the outside public with the Company. The creditors of the Company, Debenture-Holders, customers, the investing public— all have some work or other with the Company. Through correspondence, press statements etc., he supplies the required information to all concerned. He should not favour a few with any advance information, as the interests of others may be prejudicially affected. Any premature disclosure, especially in matters relating to dividend, resignation of Directors etc., may upset the entire scheme of things and hence should be avoided.

(5) **Duties as Office Executive** · Heads of various departments have frequent contacts with the Secretary. He has to supervise and co-ordinate the activities of certain departments such as accounts, taxation, registration etc. He has to collect statistical data from all the departments. Unless proper co-ordination is achieved, supply of vital information to the Board will be disrupted.

He is to recruit suitable staff and arrange for properly training them. He has to inspire confidence in them and win their willing co-operation. It is true, without doubt, that on the successful and efficient functioning of the Secretarial Department revolves the satisfaction of Shareholders and others who have contacts with the Company.

It becomes thus apparent that an efficient and energetic Secretary endowed with qualities of leadership and foresight is indispensable for a successful Company. Holding a top management position, he has to implement the decisions of the Board with sincerity. Serving as a connecting link between the Board and the management and the employees, it is his bounden duty to place their views before the Board properly and to secure justice for them all. He has to please all and neglect none.

## (h) Shareholders' Meetings

When a Company meets, the mood of the Shareholders is ascertained to particular problems taken up for discussion. Members exhibit their preference and express their willingness through passing resolutions. Shareholders' Meetings are of four types :

(1) Statutory Meeting

(2) Annual General Meeting

(3) Extra-ordinary General Meeting

(4) Class Meeting.

### (1) Statutory Meeting

This is the First General Meeting of the Shareholders. It is held only once in the life time of a Company. This must be convened only by

(i) a Public Company, Limited by Shares

and (ii) a Guarantee Company, having a Share Capital.

The Companies mentioned above must hold this Meeting of their members within six months and not earlier than one month from the date on which they were entitled to commence business.

### Importance of the Statutory Meeting

This Meeting affords its members an opportunity of knowing the details of its formation and of understanding how far its financial appeal has been successful, what capital assets have been acquired etc. Further, members can discuss on various matters relating to the Company since its very inception.

### Statutory Report

The Board of Directors should forward to every member a report called "Statutory Report" at least twenty-one days before the day on which the Statutory Meeting is to be held.

The Statutory Report sets out the following:

(1) The total number of shares, allotted both for cash and for other consideration.

(2) The total amount of cash received from shares so allotted.

(3) An Abstract of the Receipts and Payments within seven days before the date of the Report.

(4) Names, Addresses and Occupations of the Directors of the Company, of its Auditors, of its Manager and of its Secretary.

(5) Particulars of any contract as well as proposed modifications which are to be approved by the Meeting.

(6) The extent to which any Underwriting Contract has not been carried out and the reasons there of.

(7) Arrears of Calls due from the Directors.

(8) Particulars of commission or brokerage paid to any Director in connection with the issue of Shares or Debentures.

The Statutory Report must be certified as correct by not less than two Directors of the Company, one of whom must be a Managing Director. Then it should also be certified as correct by the Auditors. A certified copy of the Statutory Report must be filed with the Registrar.

The Board must prepare a list of its members and make it available at the Meeting. Members can discuss any matter relating to the formation of the Company or arising out of the Statutory Report. But they cannot pass any resolution unless previous Notice as required under the Act has been given.

Any default renders every Director or other officer liable to a fine upto five hundred rupees.

**(2) Annual General Meeting**

A General Meeting of its members every year enables them to take stock of the progress made by the Company during the year under review and to elect its office bearers for the next year.

Every Company should hold it once in a year and should specify the meeting as its Annual General Meeting in the Notice calling the Meeting. It is permitted to hold it within eighteen months from the date of its Incorporation. The interval between two consecutive Annual General Meetings must not exceed fifteen months.

**Time and Place of the Meeting**

Every Annual General Meeting should be held

(i) during business hours;

(ii) on a working day;

(iii) at the Registered Office of the Company or at some other place within the locality of its Registered Office.

If any default is made in the holding of this Meeting, any member can apply to the Central Government in this regard. It may thereupon direct the calling of such a Meeting. It may even instruct that one member of the Company present in Person or by Proxy can constitute a Meeting.

**Notice**

A Notice calling the Annual General Meeting must be given to all its members at least twenty-one days before the date of the Meeting.

**Usual business or Purposes of the Meeting**

The following business must invariably be transacted at every such Meeting:

(i) Consideration of the Audited Accounts, Balance Sheet and the reports of the Board of Directors and Auditors.

(ii) Declaration of Dividend.

(iii) The appointment of Directors in the place of those retiring.

and (iv) the appoinment of Auditors and fixing of their remuneration.

**Importance of the Meeting**

This is the most important of Company Meetings. Members in whose hands the destiny of the Company lies dormant gather together at least once a year to review the working of the Company. They get all material information as to the progress made by the Company during the year. Audited Annual Accounts, Directors' Report and Auditors' Report are all placed before the Meeting. Chairman delivers a speech listing the achievements as well as failures. Members discuss on all matters affecting the Company's affairs. If they are not satisfied with the working of the Company during the year under review or with the functioning of Directors, they take this opportunity not to re-elect those who retire. It is in this Meeting and it is by this method that they prove that it is they who wield the ultimate power of control. An awakening, enlightened body of shareholders cannot be taken for granted; if they begin to assert as a collective body, the Board has to be both responsible and responsive.

(3) **Extra-ordinary General Meeting**

All meetings of a Company other than the Statutory Meeting and the Annual General Meeting are called 'Extra-ordinary General Meetings'. This meeting is held to consider urgent business which cannot be postponed till the next Annual General Meeting.

(a) **Extraordinary General Meeting by the Board of its own motion** : These General Meetings of members are usually called by the Board to transact special business such as alteration of the Share Capital, Removal of a Director before the expiry of his term etc. Every business transaction at such Meetings is considered to be Special business.

(b) **Extraordinary General Meeting by the Board on a requisition** : The Board can call an Extraordinary General Meeting of the Company on a requisition by a prescribed number of Shareholders.

The requisition must set out the matters for the consideration of which the Meeting is to be called. It must be signed by the requisitionists and deposited at the Registered Office of the

Company. Directors must within twenty-one days of the requisition, proceed to call the Extraordinary Meeting.

(c) **Extraordinary General Meeting by Requisitonists :** If the Board fails to call the Meeting as above, the requisitionists themselves can call this Meeting.

It must be held within three months from the date of the deposit of the requisition. Reasonable expenses incurred by the requisitionists in this connection must be paid to them. This amount must be recovered from those Directors who were in default.

(d) **Extra-ordinary General Meeting by the Company Law Board:** The Company Law Board can also order the calling of an Extra-ordinary General Meeting. It can exercise this power if it is impracticable to call and conduct a meeting in the prescribed manner.

**(4) Class Meeting**

Meeting held by particular class of Shareholders are known as Class Meeting. For example, if the rights and privileges of Preference Shares are to be altered, a meeting of Preference Shareholders is to be convened and a Special Resolution passed in that Class Meeting. Other Classes of Shareholders cannot attend this meeting.

## Other Important Procedures

**Quorum**

The teım 'Quorum' refers to the minimum number of persons necessary to constitute a Meeting. If at least this accepted minimum number of persons is not present in a Meeting, the gathering will not be deemed to be a Meeting fit to transact any business.

For any Meeting of members, a minimum of five members personally present in the case of a Public Company will be the quorum In the case of a Private Company, it will be two. The Articles may, however, provide for a larger number.

**Proxy**

The term 'Proxy' refers to any person authorised by Shareholder to attend and vote at a meeting on his behalf. A member is entitled to appoint a proxy. The proxy need not be a member.

He has no right to speak at the meeting. Further the right of a proxy to vote arises only on a poll.

**Chairman of a Meeting**

Unless the Articles provide otherwise, the members personally present at the Meeting shall elect one of themselves to be the Chairman on a show of hands. If however, a poll is demanded, it must be taken in accordance with the provisions of the Act.

But usually, as Table A provides, the Chairman of the Board shall preside as Chairman at every General Meeting of the Company.

**Minutes**

It is an authentic record of the proceedings of a Meeting. It should be maintained for all Meetings of the Company. It is the responsibility of the Secretary to maintain Minutes. It is to be signed by the Chairman of the same Meeting.

## (i) Resolutions

The term 'Motion' refers to a proposal placed before a Meeting for discussion and final decision. It may be amended or retained in the original form when it is finally decided. If the motion, when put to vote, is passed by the Meeting, it becomes a 'Resolution'. Thus Resolution reflects the majority support behind a motion.

Resolutions are of two kinds:

(i) Ordinary Resolution

and (ii) Special Resolution.

**Ordinary Resolution**

A resolution which is passed by a simple majority of votes cast is an Ordinary Resolution. That is, the votes cast in favour of the resolution must exceed the votes cast against the resolution, whether on a show of hands or on a poll. This kind of Resolution is passed to transact most of the business. Wherever the Articles of the Companies Act do not require passing of a Special Resolution, Ordinary Resolution will do. Some of the items of business which require Ordinary Resolution according to the Companies Act are listed below:

**All Ordinary business**

(1) Adoption of the Audited Profit and Loss Account, Balance sheet, Director's Report and the Auditors' Report.

(2) Declaration of Dividend.

(3) Appointment of Directors in the place of those retiring.

(4) Appointment of Auditors and fixing of their remuneration.

**Special Business**

(1) to rectify the Name of a Company, when it resembles that of an existing Company.

(2) to issue Shares at a Discount.

(3) to appoint Directors not liable to retire by rotation.

(4) to remove a Director before the expiry of his period of office:

**Special Resolution**

For a Special Resolution,

(1) the intention to propose the Resolution must have been duly specified in the Notice calling the Meeting.

(2) the Notice of the General Meeting as required under the Act must have been duly given and

(3) the Resolution should he passed by a three-fourths majority. (Vtoes cast in favour of the Resolution are not less than three times the number of the votes cast against the Resolution, whether by a show of hands or on a poll).

The following are some of the items of business which require the passing of a Special Resolution:

(1) to alter the Objects Clause of the Memorandum.

(2) to change the place of its Registered Office from one State to another State.

(3) to change the Name of a Company.

(4) to alter the Articles of Association.

(5) to reduce the Share Capital of a Company.

(6) to pay interest out of Capital in certain cases.

**Resolutions Requiring Special Notice**

Either the provisions of the Act or the Articles may require sometimes Special Notice of any resolution. If a member wants to move such a Resolution, notice of his intention to move the resolution must be given to the Company not less than fourteen days before the Meeting. The Company, on receipt of any such intention must give its members Notice of such a Resolution not less than seven days before the Meeting. It must be understood clearly that the resolution which requires a Special Notice may be passed as an Ordinary Resolution or a Special Resolution, as the case may be, depending upon the matter of the resolution.

The following Resolutions require Special Notice:

(i) to appoint as Auditor, a person other than a Retiring Auditor.

(ii) to provide expressly that a Retiring Auditor should not be re-appointed.

(iii) to remove a Director before the expiry of his period of Office.

(iv) to appoint a Director in the place of a Director so removed.

**Registration of Resolutions**

Certain Resolutions and Agreements must be filed with the Registrar for registration.

The following types of Resolutions, for example, must be registered:

(i) All Special Resolutions:

(ii) Resolution requiring a Company to wind up voluntarily

## QUESTIONS

### (Short Answer Questions)

I. Answer in one or two sentences :

1. What is meant by Limited Liability?
2. Define Private Company.
3. What is a Statutory Company?
4. What is meant by Government Company?
5. Give the meaning of 'Foreign Company'.
6. Name the various clauses contained in a Memorandum of Association?
7. What is Articles of Association?
8. What is Prospectus?
9. What do you understand by a Statement in lieu of Prospectus?
10. What does the Situation clause in a Memorandum state?
11. What is a Participating Preference Share?
12. What do you understand by Cumulative Preference Shares?
13. What are Redeemable Preference Shares?
14. What classes of shares can a Public Limited Company issue?
15. Who is an Alternate Director?
16. What is meant by Share Qualification of a Director?
17. What ceiling is imposed by the Companies Act on the Share Qualification of a Director?
18. What is the maximum remuneration payable to a Managing Director?

19. What is the maximum remuneration that can be paid by a Public Company to its Manager?
20. By whom is the Secretary of a Company usually appointed?
21. Name the types of Meetings of members.
22. What is a Statutory Meeting?
23. When should a Statutory Meeting be convened?
24. What kinds of Companies should hold a Statutory Meeting?
25. What is a Statutory Report?
26. Who all can convene an Extra-ordinary General Meeting?
27. Name two usual businesses transacted at the Annual General Meeting.
28. Specify one purpose for which an Extra-ordinary General Meeting is held.
29. What do you understand by the term, 'Quorum'?
30. What does the term 'Proxy' refer to?
31. What is Special Resolution?
32. What is Ordinary Resolution?
33. What do you understand by a Resolution which requires a Special Notice?
34. State one instance which requires the passing of a Special Resolution.
35. State one item of business which requires a resolution with a Special Notice.

**(True or False Type)**

**II.** State whether the following Statements are True or False :

36. A Company with Unlimited Liability can also be registered under the Companies Act. **(True)**
37. A member of a Company can enter into a contract with his Company. **(True)**

38. Death, lunacy, insolvency etc., of a majority members of a Private Company will result in its winding up.
(False ; the life of the company is not at all affected.)

39. Registration of a Private Company is not compulsory.
(False ; compulsory)

40. All Registered Companies are not Government Companies. (True)

41. 'Companies Limited by Shares' means that there is a limit to the number of shares that can be held by a member.
(False ; it means that the liability of a member is limited.)

42. Foreign Company is a Company which, having been incorporated in India, has a place of business in a foreign country.
(False ; incorporated in a foreign country but having a place of business in India.)

43. Every shareholder of a Company, being its owner, has a right to manage its affairs.
(False ; only the Board has the right to manage)

44. Companies Limited by Guarantee can have Share Capital. (True)

45. Public Company always means a Government Company.
(False , Not always)

46. A Public Company Limited by Shares need not file with the Registrar a copy of the Articles of Association.
(True)

47 A Public Limited Company should always issue a Prospectus inviting the public to buy its shares.
(False , if capital is arranged privately, it need not issue a Prospectus)

48. Private Companies Limited by Shares can adopt Table A instead of framing Articles of their own.
(False ; should have separate Articles of their own)

49. Anything done in contravention of the Articles can be ratified by the shareholders.
(True)

50. Preference Shares carry a preferential right to dividend only.
(False ; Preferential right both to dividend and return of capital)

51. All Preference Shares are presumed to be Non-participating.
(True)

52. At the time of liquidation, Equity Capital must be returned first before Preference Capital is refunded.
(False ; only after repayment of Preference Capital can Equity Capital be returned)

53. A Public Company cannot issue Deferred Shares.
(True)

54. Deferred Shares carry a right to get dividend only after payment of dividend on other classes of shares.
(True)

55. A Company cannot act as a Director of another Company.
(True)

56 In a Public Company, the minimum number of Directors is seven.
(False ; three)

57. If the Articles authorise, the Board can appoint Additional Directors.
(True)

58. In a Private Company, the minimum number of Directors is two.
(True)

59. Every Director of a Public Company should be a graduate.

(False ; no educational qualification is prescribed by the Act.)

60. If a Director ceases to hold the Share Qualification, he vacates his office.

(True)

61. A Company cannot remove a duly appointed Director before the expiry of his term of office.

(False ; it can remove by Ordinary Resolution with a Special Notice.)

62. The Board has the power to appoint a person as its Manager even if he is already the Manager of another Company.

(True)

63. A person can act as a Managing Director of only two Companies.

(True)

64. All moneys received on account of Share Application must be kept deposited in the State Bank of India.

(False ; in any Scheduled Bank)

65. There is provision in the Act for making liability of a Director unlimited.

(True)

66. A Managing Director can be an individual, a firm or a Body Corporate.

(False ; he can be only an individual)

67. A Partnership firm can also be the Secretary of a Company.

(False ; only an individual)

68. A Director also can be appointed Secretary of a Company.

(True)

69. Statutory Meeting is a meeting held by a Statutory Company.
(False; the first meeting of the shareholders of a Public Company or Guarantee Company, having a Share Capital)

70. A Private Limited Company must hold its Statutory Meeting not earlier than one month and not later than six months from the date on which it is incorporated.
(False; a Private Company cannot hold this meeting)

71. A Statutory Meeting must be held by a Public Company at least once in every year.
(False; only once, not later than six months the date of commencement of business)

72. An Annual General Meeting of a Company must be held on a working day.
(True)

73. An Annual General Meeting of a Company must be held after business hours.
(False; during business hours)

74. Extra-ordinary General Meeting is a meeting always convened by the requisitionists.
(False; can also be convened by the Board or the Company Law Board)

75. Special Resolution is a resolution passed at an Extra-ordinary General Meeting.
(False; by three-fourths majority at any Meeting of the members)

76. No company can issue Stock.
(True)

77. A Registered Debenture-holder is a member of the Company.
(False; he is only a creditor)

78. Debenture-holders will not get interest when there is loss.
(False; interest is payable irrespective of profit)

79. All moneys received on Application for Debentures must be kept deposited with a Scheduled Bank.

(True)

80. Debentures, like Shares of a Public Company, are transferable.

(True)

III. Fill up the blanks with suitable word or words:

81. The minimun of a number of members in a Public Limited Company is———

(Seven)

82. The liability of a member of a Guarantee Company is ———

(limited)

83. A Company, in which not less than fifty-one per cent of the Paid-up Share Capital is held by a State Government, is known as———Company.

(Government)

84. A Company, the members of which under-take to contribute a fixed amount towards the assets of the Company at the time of its winding up is known as———Company.

(Company Limited by Guarantee or Guarantee Company)

85 The minimum number of members in a Private Company is———

(Two)

86. The company, which need not have separate Articles of Association of its own, is———Company, Limited by Shares.

(Public)

87 The names of persons, who have agreed to subscribe to the Memorandum, are mentioned in the——— Clause

(Subscription or Association)

88. The manner, in which the internal management of a Company is conducted, is contained in———

(Articles of Association)

89. An advertisement inviting the public to buy the debentures of a Public Company is known as———

(Prospectus).

90. Preference Shares which carry a right to arrear dividend are known as———

(Cumulative Preference Shares).

91. Such shares, as are entitled to a further dividend in addition to the usual fixed rate of dividend, are known as———Shares.

(Participating Preference).

92. A Private Company should have at least——— Directors.

(two).

93. A Director, who is appointed in the place of an Original Director during the latter's absence from the State, is known as———Director.

(Alternate).

94. The aggregate nominal value of Qualification Shares shall not exceed———rupees.

(five thousand).

95. When a Company has issued shares of Rs. 6,000 each only, the minimum number of Qualification Shares that a Director should hold is———

(one).

96. The maximum number of Companies of which a person can be a Director is———

(twenty).

97. Statutory Meeting must be held not later than——— and not earlier than———from the date on which a Public Company is entitled to commence business.

(Six months; one month).

98. A Statutory Report must be sent to every member of the Company at least———days before the date on which the Meeting is to be held.

(twenty-one).

99. The interval between two Consecutive Annual General Meetings should not exceed———months.
(fifteen)

100. The Notice, calling the Annual General Meeting, must be given to all its members at least————days before the date of the Meeting.
(twenty-one)

101. Auditors are generally appointed and their remuneration, fixed at the————Meeting.
(Annual General)

102. The minimum number of members required for the holding of a Meeting is known as————
(Quorum)

103. The Quorum for a General Meeting of a Public Company is————
(five)

104. A person appointed to attend and vote at a meeting on behalf of a Shareholder is known as————
(Proxy)

105. Altering the Articles of Association requires———— Resolution.
(Special)

**(Multiple Choice Type)**

IV. Choose the correct answer :

106. The maximum number of members in a Private Limited Company is

(a) fifty
(b) twenty
(c) fifty plus the number of employee-members.

(c)

107. Management of a Joint Stock Company is entrusted to

(a) the Registrar of Companies
(b) the Board of Directors
(c) the Shareholders (b)

108. Registration is compulsory in the case of

(a) a Partnership

(b) a Sole Proprietory Concern

(c) a Company (c)

109. The example of a Chartered Company is

(a) The East India Company

(b) The Institue of Chartered Accountants of India

(c) Reserve Bank of India. (a)

110. In a Guarantee Company, having a share capital, Pallavan holds four shares of Rs. 50 each, Rs. 40 per share paid up. The amount guaranteed by him is is Rs. 50. His liability at the time of the winding up of the Company is

(a) Rs. 90.

(b) Rs. 50.

(c) Rs. 40. (a)

111. A Private Company can commence business after getting

(a) the Certificate of Commencement of business

(b) the Certificate of Incorporation

(c) Minimum Subscription (b)

112. Rules regarding Meetings, Notices, etc., can be found in the

(a) Prospectus

(b) Memorandum of Association

(c) Articles of Association (c)

113. Prospectus is issued by a Company to invite

(a) the public to buy its shares

(b) the members to its Annual General Meeting

(c) the members to its Statutory Meeting. (a)

114. Deferred Shares can be issued by

(a) a Public Company

(b) by all kinds of Companies

(c) a Private Company

(c)

115. The rate of dividend may change every year in the case of

(a) Redeemable Preference Shares

(b) Equity Shares

(c) Cumulative Preference Shares

(b)

116. A Public Company should have a minimum of

(a) seven Directors

(b) three Directors

(c) two Directors

(b)

117. The first Directors are

(a) appointed by the Registrar of Joint Stock Companies.

(b) appointed by the Share holders at the Statutory Meeting.

(c) named in the Articles.

(c)

118. In a Company, there are nine Directors. The minimum number of Directors who are to retire by rotation every year is

(a) three

(b) six

(c) two.

(c)

119. A Director appointed in the place of an Original Director during the latter's absence from the State is known as

(a) Alternate Director

(b) Additional Director

(c) Casual Director

(a)

120. A Director should hold the Qualification Shares

(a) for two months from the date of his appointment.

(b) throughout his term of office

(c) only at the time of his appointment.

(b)

121. To remove a Director before the expiry of the term of his office

(a) an Ordinary Resolution is required

(b) an Ordinary Resolution with a Special Notice is required

(c) a Special Resolution is required.

(b)

122. The maximum number of Companies of which a person can be a Director is

(a) two

(b) twenty

(c) seven

(b)

123. One of the important duties of a Secretary is

(a) to lay down the policy of the Company

(b) to arrange for the holding of Meetings of the Board and the Company.

(c) to solve labour problems

(b)

124. The meeting which is held only once in the life time of a Public Company is

(a) Statutory meeting

(b) Extra-ordinary General Meeting

(c) Class Meeting

(a)

125. Statutory Meeting must be held

(a) by a Gurantee Company without a Share Capital

(b) by a Gurantee Company having a Share Capital

(c) by a Private Limited Company.

(b)

126. The kind of Company, that must hold a Statutory Meeting, is

(a) A Private Company

(b) A Guarantee Company having a Share capital

(c) A Statutory Company (b)

127. Dividend is declared

(a) at the Annual General Meeting

(b) at the Statutory Meeting

(c) at the Board Meeting held before the Annual General Meeting.

(a)

128. At the Extra-ordinary General Meeting of the members of a Company

(a) dividend is declared

(b) Articles are altered

(c) Auditors are appointed

(b)

129. A person, appointed to attend and vote at a meeting of members on behalf of another, member is known as

(a) Proxy

(b) Director

(c) Secretary

(a)

130. The Auditor is appointed and his remuneration is fixed at the Annual General Meeting by

(a) Ordinary Resolution of which a Special Notice should have been given

(b) a Special Resolution

(c) an Ordinary Resolution

(c)

## (Matching Type)

V. Match the items in List A with those in List B :

| List A | List B |
|---|---|
| 131. Perpetual succession | (a) Acknowledgement of indebtedness |
| 132. Association Clause | (b) Table A |
| 133. Articles of Association | (c) Continued existence despite change in membership |
| 134. Statement in lieu of Prospectus | (d) Situation Clause |
| 135. Debentures | (e) Private arrangement of capital |
| | (f) Association not for profit |
| | (g) Subscription Clause |

(131—c; 132—g; 133—b; 134—e, 135—a)

| List A | List B |
|---|---|
| 136. Minutes | (a) Minimum number of members necessary for a Meeting. |
| 137. Ordinary Resolution requiring a a Special Notice | (b) A person appointed to attend and vote at a meeting on behalf of a member. |
| 138. Quorum | (c) Record of the proceedings of a meeting. |
| 139. Proxy | (d) Proposal placed before a meeting. |
| 140. Motion | (e) Support by a simple majority. |
| | (f) Support by three-fourths majority. |
| | (g) Notice of twenty-one days. |

(136: c; 137: e; 138: a; 139: b; 140: d)

| List A | | List B |
|---|---|---|
| 141. Special business of a meeting of members | (a) | Appointment of Directors in the place of those retiring. |
| 142. Statutory Meeting | (b) | Appointment for a period not exceeding five years at a time. |
| 143. Managing Director | (c) | Extra-ordinary General Meeting |
| 144. Secretary | (d) | Statutory Company |
| 145. Annual General Meeting | (e) | the first meeting of a Public Company. |
| | (f) | An employee of the Company. |
| | (g) | Special Resolution. |

(141: c; 142: e; 143: b; 144: f; 145: a)

## Essay Type Questions

146. Define a Joint Stock Company and bring out its essential features.

147. Explain briefly the chief points of distinction between a Joint Stock Company and a Partnership.

148. Is Joint Stock Company superior to a Partnership? If so in what respects?

149. What kinds of Companies can be registered under the Companies Act, 1956?

150. Enumerate the differences between a Private Limited Company and a Public Limited Company.

151. State the privileges enjoyed by a Private Company.

152. Briefly explain the formation of a Public Limited Company.

153. What documents and statements are to be filed with the Registrar by a Public Company at the time of its registration?

154. Explain the various Clauses of Memorandum of Association of a Company.

155. What is an Articles of Association? What are its usual contents? What kinds of Companies should frame Articles of their own?

156. Briefly state the contents of a Prospectus.

157. Describe briefly the different kinds of Preference Shares.

158. Explain 'Debenture'. What are the differences between Share-holders and Debenture-holders?

159. Explain the different kinds of Debentures.

160. How can Directors be appointed?

161. What specific powers do Directors have? What limitations are there on the exercise of certain powers?

162. Explain the provisions of the Companies Act with regard to Statutory Meeting.

163. State briefly the Statutory duties of Directors.

164. State the provisions of the Companies Act with regard to the appointment and remuneration of a Managing Director.

165. Briefly explain the duties of a Company Secretary.

166. What are the contents of a Statutory Report?

167. What is an Extra-ordinary General Meeting? By whom can it be convened?

168. What is an Annual General Meeting? State briefly the provisions of the Companies Act with regard to its holding.

169. What is Ordinary Resolution? What purposes require the passing of an Ordinary Resolution?

170. What is Special Resolution? What items of business require Special Resolution?

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CHAPTER IV

# CO-OPERATIVE ENTERPRISES

The Co-operative Society is another form of Business Organisation. Like a Joint Stock Company, it is also an association of persons in business legally created. But it differs from the other three forms of business organisation in many respects.

**Need for Co-operatives**

Sole Proprietorship, Partnership and Joint Stock Company represent capitalistic forms of business organisation. Capitalism always aims at maximisation of private gain and enlargement of the private properties of the owner or owners of such business in utter disregard of social well-being. This evil is not very much apparent in the operations of a Sole Proprietorship or Partnership as they are small units and cannot affect the entire society. But the operations of a Joint Stock Company, being very large and varied, touch upon society in many ways. Hence the above evils of capitalism are very much manifest in the working of the huge Joint Stock business. The capitalistic entrepreneurs exploit the workers by overworking them and under-paying their wages. Similarly they fleece the consumers by overcharging for their goods and underweighing the articles sold and also supplying inferior goods.

Where social welfare is affected, if the affected sections cannot protect themselves, it is the duty of the State to come to their rescue. But till very recently, Governments in various countries were following the policy of laissez faire-i.e., non-intevference or least intervention in economic affairs of individuals.

One answer to end the evils of capitalism is "Socialism". But Socialism is also not an unmixed blessing. Socialism envisages State Ownership and control over all resources and

elimination of private property. This curbs individual freedom and intiative.

In Communism, the State is everything and the individual exists only for State. The principle is "Each for All and All for All"

Co-operation comes as a golden mean between Capitalism and Communism. The economically exploited sections of society come together into the Co-operative enterprise. By self-help and mutual help, they try to solve their common economic problems. They learn thrift and the importance of savings. They join together as men. Men rule over money. The importance of money is kept down to the proper limit. The value of the individual human being is regarded as sacred and democray is nourished.

Thus the need for Co-operative Association of the economically weak arose in various countries. But the purpose of the association in different countries varied as people in each country had their own particular economic problems. But generally we can say that 'Usury' and 'Profiteering, were the two evils which Co-operation fought successfully. In Germany and India, Co-operatives were started to do away with the rapacious money-lenders who had their strangle-hold on the poor rural farmers and the urban artisans. In England, Consumers' Co-operation took roots to fight the greedy traders who overcharged and under-supplied even the necessaries of life of the poor workers. In France and U.S.A., the producers started their own Co-operatives to eliminate middlemen and market their products at fairly remunerative prices.

The Co-operative form of association is not merely a form of doing business. It is more a way of life.

**Definitions**

There can be no single all-embracing definition of a Co-operative. This is because Co-operative Association had taken shape in different countries to solve different kinds of economic problems of the socially weak. In some countries there

had been no state participation. In some other nations, the Co-operatives were State-sponsored and State-controlled. In certain other parts of the world, the State exercised a beneficial and nurturing control.

The word, 'Co-operation' is derived from the Latin word 'Co-operari' meaning "to work with". So Co-operation means working together with others for a common purpose.

**Calvert:** "Co-operation is a form of organisation wherein the persons voluntarily associate together as human beings on a basis of equality for the promotion of economic interests of themselves."

**Dr. C. R. Fay:** "A Co-operative is an association for purposes of joint trading, originating among the weak and conducted always in an unselfish spirit on such terms that all who are prepared to assume the duties of membership may share its reward in proportion to the degree in which they make use of the organisation."

**Sir Horace Plunkett:** "Co-operation is self-help rendered effective by organisation. It is Better Farming, Better Business, Better Living."

**Features of Co-operative Organisation**

A study of all the above definitions clearly brings out the important features of a Co-operative Society.

(1) **Voluntary Association:** A Co-operative Society is an association of persons who join it voluntarily. A person joins a Co-operative if he feels that it will be good for him. Similarly a person can leave the Society whenever he wishes; No person can be compelled to join a Co-operative or to leave it. Compulsion and Co-operation are contradictory terms. A person, if compelled, to join a Co-operative, will not Co-operate with the others and give his best. Similarly any person who is a member, if compelled to resign, will not contribute his best to the affairs of the Society. So membership is always voluntary.

But there are some cases when a person can be compelled to join a Society. In certain types of Co-operative enterprise, when the majority of persons join, then the minority can be compelled to become members for the welfare of all the persons in the community. E.g., in an Irrigation Society in a village.

(2) **Plural Membership**: As a Co-operative is an association of persons, there must be more than one member. Law fixes the minimum as ten persons and the maximum is unlimited. The minimum is fixed at ten because only if at least ten persons agree to join, the legal formalities of formation can be gone through. Grouping of at least ten persons will indicate the existence of some common economic problem which they want to solve. There is no limit on the maximum membership as any number of persons may have the same economic problem in future and can join.

(3) **Legal Capacity**: The members forming the Co-operative must be major persons without any contractual incapacity. This is necessary as they are bound by the rules and regulations of the Society and are deemed to agree to such rules. A person must have the legal capacity to make agreements.

(4) **Open Membership**: Any man or woman belonging to any caste, community or creed can join a Society. Illiteracy is also not a bar to membership. Both the highly rich and the lowly poor can join. The Share Capital and Entrance Fee are kept very low to help even the poorest of the poor to join the Society. There is also no religious discrimination.

(5) **Finance**: Any business unit must get capital from its owners. A Co-operative also gets capital from its members. But the Share value is fixed at a low amount to assist even the poor to buy shares in the Society. To get extra money, the Society can borrow from Central Co-operative Banks and State Co-operative Banks.

(6) **Associated as Human Beings**: Wealth makes the owner of that wealth to forget that others are also human beings.

A Co-operative always emphasises on the importance of the human being in its organisation. In a Co-operative, a person becomes a member not due to his wealth but because he is a human being. In a Co-operative 'man' is most important and 'money' Cannot rule 'man'. A prince and a peasant can be members. They will have the same rights and responsibilities.

(7) **One-man, One-Vote :** To emphasise the importance of man and not money in a Co-operative, every member has got only ONE vote irrespective of the Share Capital paid by him. This is to keep out the dominance of money power in the management of the Society.

(8) **Limited Return on Capital :** Unlike a Joint Stock Company, a Co-operative gives less importance to money power. So the return given on capital invested is a fixed percentage (9%) whatever be the profits earned. This prevents rich people from dominating the Society.

(9) **Limit on Maximum Share Capital Holding :** Usually in a Co-operative, a member cannot hold more than a fixed amount of Share Capital. This is to discourage very rich persons from dominating the Society. The 'one-man, one-vote' principle also serves the same purpose. The interest on capital is also limited for the same reason.

(10) **Common Economic Needs :** The purpose of the Co-operative Association is to find remedies for the common economic problems of the members. So only persons who have common economic ills can associate themselves in at Co-operative. A poor, worker wants necessaries of life a cheap prices and a poor farmer wants to sell his produce at reasonably high prices. These two can not be members of the same Co- operative as their economic needs are not the same.

(11) **Local Membership :** Generally in any Co-operative, people in that locality, e.g., village, become members. This is because only people in a particular locality can have a common economic problem. So generally every Co-operative has a defined

operating area and persons living in that area can avail of that Society.

(12) **Democratic Control:** In a Co-operative Society, the management is truly democractic. Each member has only one vote and money has no influence. All the members, called the General Body, meet annually and elect their representatives from among themselves to manage the Society for that year. This smaller representative body is known as the Managing Committee or the Board of Directors. An honorary or a paid Secretary looks after the daily management under the supervision, direction and control of this Managing Committee.

(13) **No Political Influence:** A politician can join a Co-operative as a member but politics cannot enter into its management. This makes a Co-operative, 'non-political.'

(14) **Distribution of Surplus:** In a Co-operative, there is 'Distributive Justice'. That is out of the annual profits, capital is paid a fixed rate of return as interest. A fixed portion of the profits is kept as reserve to strengthen the finances of the Society. Another fixed percentage of the profits is kept for utilisation for the common good of the Society (Common Good Fund). The remaining amount is distributed to members in proportion to their patronage of the Society. This is called as 'Patronage Dividend' and helps to cultivate the loyalty of the members to their Society. This is the reward to members for their full and sustained support to the Society.

(15) **State Control:** In every country, Co-operatives are regulated by the Government to a greater or a lesser extent. But in India, the State has been playing an active role in formation and running of the Co-operatives. This is due to the illiteracy and ignorance of the people about Co-operative principles and also because of the usual expectation of our people that the Government will and must do everything for them. So in India, there is more of State Control and even State participation in Co-operative ventures. The Registrar of Co-operative Societies, in every State, assisted by Deputy Registrars and various officials of the Department of Co-operation control the various societies

under the Co-operative Societies Act, 1912 (a Central Act) or under the relevant State Act [Eg., in Tamil Nadu, The Madras (now Tamil Nadu) Co-operative Societies Act, 1961 ].

(16) **Registration**: A Co-operative Society must be registered under the Central Act or the State Act applicable to societies in that State. The Society is legally created only after such registration. Co-operative Societies have concessions regarding registration fees, stamp duty, etc.

(17) **Perpetuity**: A Co-operative Society is a separate legal entity apart from its members. So, like a Joint Stock Company, it is also permanent and is not affected by any change in its membership.

(18) **Liability**: The liability of the members of a Co-operative Society is generally limited to the capital taken by them. But in a Village Society, the members' liability can be unlimited. This is to increase the borrowing powers of the Society and also to make its members take a keen part in its management.

(19) **Self-Help and Mutual Help**: Every member of the Society is expected to help himself and also help every other member. So all members are expected to have close personal knowledge of one another. This is another reason for legal membership.

(20) **Statutory Audit**: The affairs of a Co-operative will be audited annually by the officials of the Department of Co-operation of the Government.

(21) **Service and Net Profit**: The main aim of a Co-operative is to render service to its members and to the community at large. It does not operate only to make profit for itself. But since service can not be done efficiently unless profits are earned sufficiently and regularly, the Society must aim at profits. The motto of a Co-operative is "Each for All and All for Each." This is different from Capitalistic Enterprise where the aim is "All for the Owners" and from socialistic business where "Each for All and All for All" is the guiding principle.

(22) **Moral Force :** The Co-operative always aims at improving society. So it postulates honest business practices, supply of quality goods in correct measurements and encouragement of thrift through cash transactions and discouraging credit dealings.

(23) **No Share Transfer :** Since a Co-operative is an association of persons with common economic needs, it does not allow transfer of shares by a member. But it will repay the share capital to an outgoing member.

**Co-operatives–an Evaluation**

Co-operative Societies enjoy many advantages. But there are also certain weaknesses which have affected the unqualified success of Co-operatives. We will first consider the advantagos.

**Advantages**

(1) **Easy Formation :** A Co-operative can be easily formed without costly legal formalities. The procedure for registration is very simple.

(2) **Democratic Management :** In a Co-operative, man is more dominant and money is not all powerful The principle of 'One man—One vote' ensures that control is not cornered by a small minority of members holding very large number of shares. The limitation on individual share-holding also minimises chances of concentration of control in a small minority of members. As **Darling** said "Co-operatives are training ground in self-government."

(3) **Limited liability :** Like a Joint Stock Company, a Co-operative also confers the benefit of limited liability on its members. This attracts the small savers and middle class people who can buy shares without risk of losing their meagre private assets.

(4) **Self-financing :** A Co-operative cannot give all its profits as dividends to its members. Return on capital invested by members cannot be more than 9% per year A Co-operative

has to keep 25% of its annual profits as 'Reserve'. This reserve helps the Society to build up its financial strength and can be used for expanding the business. Thus business expansion can take place with owned funds or 'ploughed-back' profits.

(5) **Perpetuity**: Like a Joint Stock Company, a Co-operative also has permanent legal existence. So its continuance is not affected by any change in its membership.

(6) **Privileges**: A Co-operative enjoys certain privileges in law. E.g. Exemption from Income Tax for incomes less than Rs. 15,000/—p.a. Exemption from Registration Charges and Stamp Duties etc. This helps in easy formation and operation of such Societies.

(7) **Co-ordination in Management**: All the members of the Society are generally living in the local area. Besides only persons having a common economic problem join a Co-operative Society. So in every Co-operative Society, there will be harmony of interests of all members and no conflict of effort.

(8) **Government Help**: A Co-operative Society is helped by the Government in many ways. In our country, especially, Co-operatives are fully nurtured with Government patronage from the time of their creation. In fact, it is said that in India, Co-operatives are actively sponsored and supported by the State.

(9) **No Speculation in Shares**: In a Co-operative, any person can buy shares at any time. So there is no possibility of speculative dealings in the shares of Co-operatives. This saves the investors from loss due to unscrupulous speculation.

(10) **Benefit to Economically Weak**: The Co-operative aims at lifting up the economically down-trodden. So its share value is very low. Hence even poor people can benefit from membership in a Co-operative.

(11) **Aim of Mutual Prosperity**: The principle of a Co-operative is "Each for all, All for Each". So unlike a Joint Stock Company, a Co-operative, even if it is very strong and successful, does not try to drive out its rivals from business.

(12) **Distribution Justice:** The practice of the Co-operatives giving 'Patronage Dividends' to its members as a reward for their loyalty to the Society is aganist the concentration of wealth among a few rich.

(13) **Moral Force:** A Co-operative tries not only to improve the economic welfare of its members but also attempts at building up a better society. It spends from its Common Good Fund for social welfare measures like medical aid to the poor, etc. It develops in its members a spirit of service and thrift.

In actual practice, Co-operatives suffer from many hardships. These affect the successful growth of Co-operatives.

**Disadvantages**

(1) **Limited Finance:** The low share value of the Co-operative cannot procure a large capital even though large number of members may join. This is because of the restriction on maximum shareholding by an individual member. Also the Statutory ceiling on Dividend on Capital prevents rich people from joining the Society.

(2) **Non-transferability of Shares:** In a Co-operative, a member cannot transfer his share freely. He can be allowed to withdraw his capital. This prevents many people from joining the Co-operative.

(3) **Rigid State Control:** The Co-operatives are controlled very strictly by the Government through the Co-operative Societies Act. This inhibits the freedom of action of Societies as its opetations have to strictly follow the rules and regulations of the Act and the Government.

(4) **In-efficient Management:** In a majority of Societies the members are illiterate and ignorant about the principles of Co-operation. So the efficiency of management is lacking. These societies cannot employ trained and efficient persons for management as they cannot pay attractive salaries because of very poor financial position.

(5) **Lack of Secrecy:** In a Co-operative, secrecy of operations cannot be maintained as all members can take very active part in knowing its operations.

(6) **Internal Quarrels:** Many Co-operatives fail because of constant group rivalry and quarrels among members. Each group will try to dominate the Society.

(7) **Political Influence:** In theory, Co-operation is neutral in politics. But due to too much Government control, a Co-operative Society is influenced very much by politics. In a democracy, the Government can be changed. So the policies of the Co-operative may also be affected by political changes. This is not good for successful business.

(8) **Lack of Motivation:** The employees of a Co-operative do not have sufficient financial rewards for maximum efficiency in management. The rich people do not join because the motivation of high dividends on capital is absent.

(9) **No Large-Scale Business:** Though there are some exceptions like the Khaira Milk Supply Co-operative (AMUL) in Maharashtra, generally a Co-operative cannot embark on huge business enterprise.

(10) **No Universal Application:** Co-operative business cannot be successfully applied to all types of industrial and business ventures. Only in certain fields it has succeeded in different degrees in various countries.

**Co-operative Movement in India**

India is no stranger to the idea of co-operation. Our ancient village economy was based on economic Co-operation among the villagers. All the villagers co-operated in every activity in the village. References about Co-operation are made in Chanakya's "Arthasastra".

When the British started ruling our country, our old system of village management disappeared. But the modern Co-operative Movement started only from 1904. Our farmers were very much in debt to the greedy money-lenders and traders. Their

economic status was very pitiable. The Government wanted to help them. So the then Madras Government sent one official, Mr. Nicholson, to Germany to study about the German Rural Credit Co-operatives. He recommended in 1895 that such Rural Credit Societies could be started in India also.

So in 1904, the Central Government passed the Credit Co-operative Societies Act. A number of Credit Co-operatives were started to lend money cheaply to the rural people. But this Act did not provide the starting of other types of Co-operatives or Central Co-operatives. So in 1912, the Government of India passed a new Act called the Co-operative Societies Act. This Act provided for the starting of different types of Societies and also Federations of Co-operatives.

Under the Government of India Act of 1919, Co-operation became a Provincial (State) subject. Many Provinces passed separate Acts to regulate the Co-operative Societies in their own Province (State). In the then Madras Province (now Tamil Nadu), the Madras Co-operative Societies Act was passed in 1932. Now all Co-operatives in Tamil Nadu are regulated by the Tamil Nadu Co-operatives Societies Act, 1961.

**Formation of a Co-operative Society**

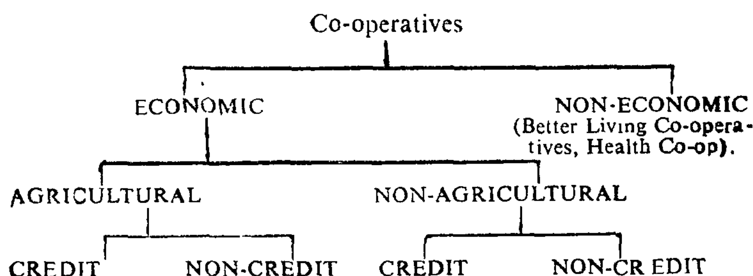
Any TEN adult persons living in a certain locality and legally capable of making a contract can start a Co-operative Society to provide for their common economic need by mutual help. They must prepare the Bye-laws (rules) of the proposed Society and apply to the Deputy Registrar of Co-operative Societies of that district along with a copy of the proposed Bye-laws. The Deputy Registrar, if satisfied about the need and correctness of their application, will register the Society and issue the Certificate of Registration under his Official Seal and Signature. Then the Society is legally created.

**Types of Co-operatives**

The principles of Co-operation have been applied in different countries to solve different kinds of economic problems. For example, in Germany, Credit Co-operatives were started to

provide cheap loans to the farmers in villages and the small artisans and traders in cities to save them from the greedy money lenders. In England, Consumer's Co-operatives were started to supply quality goods at cheap prices in correct measure to the poor people who became its members.

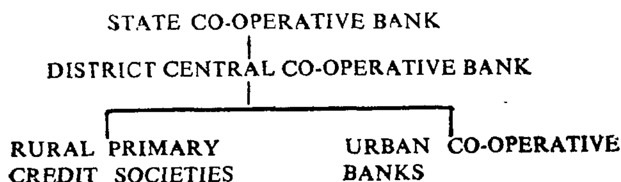
The following Chart gives an idea of the types of Co-operatives :




**Credit Co-operatives**

A Credit Co-operative aims at providing adequate loan facilities to its members at cheap rates of interest on easy repayment terms. It may be an Agricultural Credit Co-operative, financing the farmers in villages or a Non-Agricultural i.e. Urban Society (or Urban Bank) providing loans to non-agriculturists, e.g., Small Traders, Small Industries etc.,

The Credit Co-operatives have a three-tier structure. At the bottom, there are the large number of Primary Village Credit Societies and Urban Credit Societies or Urban Co-operative Banks. Above them, we have the District Co-operative Central Banks, one in each district. At the top, there is the State Co-operative Bank, one for each State.



### Primary Credit Societies

These are formed in villages or towns. Any ten persons can join and start such Societies. They get funds from the Entrance Fees and Share Capital of members, deposits received from members and the public and loans borrowed from the Central Co-operative Bank in their district. They lend money to their members for productive purposes and also for consumption. They have freed the villagers aud small traders in the towns from the clutches of the money-lenders. They have also helped the members in learning the habit of thrift and savings. Such Societies have taught their members the banking habit. They help in collecting rural savings for National Development.

### District Central Co-operative Banks

There is one Central Co-operative Bank for every district. All the Primary Credit Societies and Co-operative Banks in a district take share capital in the Central Co-operative bank in their district. Individuals are also members in such Central Banks. The Central Co-operative Bank gets funds from Share Capital, deposits of Member-Societies and individual members, deposits from the public and loans borrowed from the State Co-operative Bank. They lend money to their Member Societies whenever such loans are needed by those Societies. They are the Central Financing Agencies for such Primary Societies and Banks. They guide such Societies in proper management.

### State Co-operative Bank

In every State, there is generally one State Co-operative Bank called the 'Apex Bank'. All the District Central Co-operative Banks in that State and also some individuals become members of the State Co-operative Bank. The State Co-operative Bank obtains funds from share capital paid by its members, deposits of members and the public and loans from State Bank of India. The State Co-operative Bank will lend money to the District Central Co-operative Banks whenever needed by them. They also advise and guide the District Central Banks in business matters.

The Credit Co-operatives have succeeded to a large extent in saving the poor villagers from the evil influence of the money-lenders. But due to the general defects of the Co-operative movement in India, they have not been able to completely replace the money-lenders in providing rural credit.

**Consumers' Co-operatives**

Consumers' Co-operation was successfully developed first in England by the Rochdale Pioneers. In India, the Consumers' Co-operatives have succeeded notably in Tamil Nadu and Maharashtra.

Consumers' Co-operatives aim at rescuing the poor consumers from the hold of the greedy traders. The traders generally cheat the poor people by over-charging prices, under-measuring the goods sold and selling inferior quality goods. The poor people can not fight the traders, as they usually buy on credit.

Any ten persons in a place can start a Consumers' Co-operative Society popularly known as a Co-operative Store. The members pay Entrance Fee and Share Capital which is of low value to help even very poor persons to join the Society. The Society purchases the various goods needed by its members directly in bulk from the wholesale merchants or even the factories. This eliminates the middlemen and their commission. The Society takes care in buying quality goods from the best sources.

A Consumers' Co-operative works on three most famous principles followed by the Rochdale Pioneers. They are: (1) Sale to members; (2) Sale for cash; and (3) Sale at Market Rates.

**Sale to Mombers:** The Store is only for the members. So, it will sell its goods only to members. But now this rule is relaxed. Co-operative Stores now sell goods to non-members also. But only members are given a discount on their purchases or a share of annual profits according to their annual purchases from the Store.

**Sale for Cash:** A Co-operative always aims at improving the welfare of its members. So a Store always sells goods to

its members only for cash or against deposit of money. This is because credit sale will encourage the members to over-purchase goods and buy unnecessary goods. Then the members will fall in debt and find it very difficult to repay the Store. The Store, by its principle of "Cash Sales only", encourages thrift of members. But now some Societies permit credit sales to their members.

**Sale at Market Rate :** The Store sells goods to members and others only at the prevailing market price. But members will be given a share of profits at the end of the year or a discount when purchasing goods.

**Central Co-operative Wholesale Society**

All the Primary Stores in each district become members of the District Co-operative Wholesale Society. There will be one such society for each district. This District Wholesale Store buys goods from wholesalers or producers at cheaper prices and supplies them to all its member-stores regularly.

There is a National Consumers' Co-operatives Federation to guide the various Consumers' Co-operatives at different levels in each State in India.

**Co-operative Super Markets**

A Super Market is a very big store where people can buy all their needs. The Super Market is usually started as a Joint Stock Company for private profit. But a Super Market can also be started on co-operative lines. They are usually located only in cities and big towns as they must have large daily sales to earn profit on their large capital out-la y.

People can join a Co-operative Super Market by taking a Share and paying the Entrance Fee and Share value. The Share Value is very low to enable even very poor people to join. The member is given a 'Membership Card' which he must produce when buying goods. This will help to get the 'Membership Discount' on his purchases. Non-members can also buy from the Super Market but are not entitled to any discount,

The Super Market will have various departments like textiles, medicines, grocery, vegetables, furniture etc., In each department, the goods wil l be attractively displayed with their prices marked in cards. The price is a fixed price and there is no bargaining. There are many salesmen and sales women to help the customers to buy the goods, to put the bill and collect the cash. Home delivery of goods is also given. Sales are for cash generally.

The Co-operative Super Market, not only buys goods in bulk from different wholesalers and manufacturers, but also undertakes production of certain goods like edible oil etc.

Examples of Co-operative Super Markets in Tamilnadu are Chinthamani Super Market in Tiruchirapalli and Coimbatore, Kamadhenu Super Market in Madras, Karpagam Super Market in Vellore (North Arcot District) etc.

Co-operative Super Markets help consumers in many ways as below :

(1) People can buy quality goods always.

(2) They are supplied scarce commodities on production of Membership Card.

(3) Cash Sales prevent people from over buying and falling into debts.

(4) Membership Discount on Purchases develops thrift in members and encourages them to buy goods always from the Super Market.

(5) Goods are sold after cleaning and packing. So consumers are assured of particular quality of goods bought. No adulteration of goods is practised.

(6) Correct weighments are used. So consumers are not cheated by short weighing.

The Government aims at starting many more Co-operative Super Markets to serve the public in different towns in the State.

**Co-operative Societies and Companies – A Comparison**

Both these types of business organisation are associations of persons. Both are incorporated under law. On registration, both of them acquire the traits of Legal Entity, Common Seal and Perpetual Succession. Both are managed by managing committee called Board of Directors. In both the organisations. the representatives comprising the Board of Directors are elected by the General Body of members. Both are democratic in management. In both the organisations, the members' liability will be generally limited. Despite the above similarities, they are two different types of organisation. The differences are :

(1) **Object :** Co-operatives are mainly service organisations. They aim at improving the material welfare and ethical standard of their members by removing their common economic problems. They emerged with a view to protect the poor people from the exploitation of Capitalist Enterprises. They do not primarily aim at profit.

But the primary aims of Companies is profit-making. Motivated by profit considerations, they utilise all available business opportunities. As Capitalist Enterprises, they try to exploit the public.

(2) **Management:** In a Co-operative, all its members are equal. This equality arises from the principle of "One Man, One Vote". There is a maximum limit to the shares that a member can hold. The members of the Managing Committee are elected only with the support of the majority of members. Here economic democracy is actually in practice.

In a Company, equality among members does not prevail. The principle of "One Share, One Vote" and the absence of a maximum limit to share-holding enable a member to have many votes. Hence it is not the majority of a members, but the big shareholders that elect the members to the Board of Directors. It is a known fact that management of Companies is in the hands of a few big shareholders. So, there is oligarchy instead of democracy.

(3) **Capital :** In a Co-operative, man is more important than money. Man rules over money. Money is not the main consideration for admitting a member. Here members can not transfer their shares among themselves or to outsiders.

A Company gives more importance to money than to man (Shareholder). A share holder's importance depends on the number of shares held by him. A member can hold any number of shares. He can freely transfer his shares.

(4) **Number of Members :** To form a Co-operative, there must be at least ten persons. There is no maximum limit the number of its members.

But two and seven persons are sufficient to form a Private Company and a Public Company respectively. There is no maximum limit to the number of members in a Public Company; however in a Private Company, the maximum is fifty excluding its present and past employee-members.

(5) **Distributive Justice :** A Co-operative uses only a small portion of its profits to give a low return on capital to its members. But a major portion of its profits is used to give 'Patronage Dividends' to its members. Thus a member's dividend has no bearing to the number of shares he holds.

But a Company distributes dividends only on the basis of its shares; a member holding more shares will get larger dividend.

(6) **Return of Share Capital :** A member can withdraw his share capital while leaving the society.

But a Company can not return the share capital to its members except in the event of its winding-up.

## QUESTIONS

**Section A — Objective Type**

**I. Fill in the blanks with suitable word:**

(1) ............is the golden mean between capitalism and communism. (Co-operation)

(2) Co-operation is the......(1) association of persons as ...........(2) beings to solve their...........(3) economic problems by.........(4) help and self-help.

(1) voluntary (2) human
(3) common (4) mutual

(3) A.........(1) Co-operative aims at.........(2) money at .........(3) rate of interest on easy repayment terms.

(1) credit (2) lending (3) cheaper

(4) A Consumers' Co-operative usually sells goods for ......(1) at......(2) rates to its members.

(1) cash (2) market

(5) For each district, there will be one District.............. Co-operation Bank. (Central)

II. State Whether True or False.

(6) A Co-operative aims at better service through profit. (True)

(7) In a Co-operative, the maximum membership is 200. (False ; unlimited)

(8) Co-operatives in India are governed by the Indian Companies Act, 1956.

(State or Central Co-operative Societies Act)

(9) A Co-operative Society can be started for non-economic purposes also.

(True)

(10) Consumers' Co-operation was first successful in Germany.

(False; in England)

III. **Indicate the correct answer by encircling the letter a, b or c as the case may be.**

(11) Minimum membership in a Co-operative is

(a) 50 (b) 10 (c) 7 (b)

(12) A Co-operative Store gives dividends to its members on the basis of

(a) Share Capital taken
(b) Number of Shares bought
(c) Amount of patronage given (c)

(13) In a Co-operative Society, the shares of a member

(a) can be transferred
(b) can be repaid
(c) can not be transferred or repaid

(14) A Co-operative Super Market supplies

(a) Credit (b) Service (c) Goods (c)

(15) Co-operatives can be started

(a) only in villages
(b) in towns and villages
(c) only in cities (b)

IV. Match the items in List with 1 with those in List2 :

| | List 1 | | List 2 |
|---|---|---|---|
| (16) | Producers' Co-operative | (a) | Cheap loans |
| (17) | Consumer's Co-operation | (b) | Operating at district level |
| (18) | Co-operative Motto | (c) | Laissez Faire |
| (19) | Co-operative Bank | (d) | One Share, One Vote |
| (20) | Co-operative Central Bank | (e) | Rochdale Pioneers |
| | | (f) | Better prices |
| | | (g) | Each for All. All for Each |

**Match Panel**

| List 1 | | List 2 |
|---|---|---|
| 16 | — | f |
| 17 | — | e |
| 18 | — | g |
| 19 | — | a |
| 20 | — | b |

**Section B—Short Essay Type (One page Answer)**

(21) What is a Co-operative Society? How is it formed?

(22) Explain the working of a Credit Society.

(23) How does a Co-operative Store function?

(24) Mention briefly the advantages of Co-operatives.

(25) Explain in brief the important principles of Co-operative Societies.

(26) What is a Co-operative Super Market?

VI **Section C-Essay Type Questions (Three page answer)**

(27) Define Co-operation and bring out clearly its features

(28) Explain the organisational structure of Credit Co-operative Movement in our country.

(29) Compare a Co-operative Society with a Joint Stock Company.

(30) What are the benefits and demerits of Co-operatives?

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## CHAPTER V

# GOVERNMENT IN BUSINESS

State Enterprise is any industrial or commercial unit owned and controlled by the Government, Central or State or both. The Government of a country, owning and actively managing business and industry, is a very recent development. The usual role of Government till recently was only regulating commerce and industry and providing facilities for successful running of industrial and commercial units. But Industrial and Commercial units were owned by private individuals.

State Enterprise is also known as 'Public Sector' or 'Public Enterprise'. Modern Governments aim at building up a 'Welfare state' on 'Socialistic Pattern.' They also want to reduce the concentration of income and wealth in a few hands and develop essential industries and also various regions. This cannot be done by private enterprise as they work only for private profit and not in public interest. Hence, the modern State has started getting directly involved in ownership and control of Indastrial and Commercial Organisations.

The Government can own and control industry and business in two ways: (1) by starting a new unit or (2) by taking over an established Industrial or Commercial Unit owned by private persons. This second method is known as 'Nationalisation'.

**Objectives of State Enterprise**

Government generally starts Industrial and Commercial Ventures with the following objectives:

(1) **For Defence Needs**: Defence of a Country from foreign aggression is most important. If Defence Industries are owned by private individuals, then in times of National

Emergency, such private individuals may not always co-operate with the State. There is also the danger of defence secrets being given out to the enemy. So, for the security of the country, Defence Industries are always owned and managed by the State.

(2) **Developing Basic Industries :** Certain basic industries like Chemicals, Iron and Steel are most essential for economic growth. They must be developed only as State-managed u nits.

(3) **Essential Undertakings :** Certain undertakings like Water Supply, Electricity Generation, etc, are most important for all people throughout the country. They must be only under Government ownership and control. Otherwise the public will suffer.

(4) **Building up Infra-structure :** For rapid economic growth, certain industries like Transport, Communication, etc., must be developed thoroughly. This is possible only under State ownership and control.

(5) **Preventing Concentration of Economic Power :** Private business units always aim at profits and gainings of economic power. Concentration of economic power in a few hands is not good for the country. To prevent this, the Government must control the 'Commanding Heights' of the economy.

(6) **Avoiding Waste of Resources :** Private businessmen will start their units only in those areas where there is assured profits. So a number of business units may be started in the same line of business. The country's financial, human and material resources will be wasted in such industries. They may not be available for more essential but less profitable business. The Government can start industries more useful for the people even though less profitable.

(7) **Balanced Regional Growth :** The private business man will start business only in those parts of the country already developed economically. So certain areas in the country

will be neglected and they will be very backward in economic growth. The Government can plan industrial development of various regions in a balanced manner.

(8) **Making for Full Employment:** The State, by proper centralised planning of industrial development, can aim at maximum employment of all available resources. This is most important in a developing country like India.

(9) **For Social Welfare:** If Government runs industries the profits will increase the finance of the State. This will help the Government spend more on 'Social Welfare Schemes' like Education, Medical help, Housing, Road-building, etc. These will improve the economic conditions of all the people, especially the poor people.

**Forms of Organisation of State Enterprise**

The Government can organise an Industrial or Commercial Unit in any one of the following forms:

(1) as a Department of the Government;
(2) as a separate Corporation;
(3) as a Joint Stock Company.

The choice of the particular form of organisation depends upon the nature of the industry, the circumstances in that country and the policy of the Government.

**Departmental Form of Organisation**

The particular industry may be run as a Department of the Government. e.g., Post and Telegraphs Department. Here this Department is a part of the Government under the control of a particular Minister. This is the oldest form of organisation of State Enterprise.

**Features**

(1) The Industrial or Commercial Venture is a part of the Government. It comes under the direct control of a Minister.

(2) Government officials are in charge of managing the business. They are responsible to the particular Minister.

(3) The finance needed for the business is provided in the Budget of the Government and is appropriated for this business annually.

(4) The Government gets the income from this business.

(5) The affairs of the business are subjected to strict Government Budgeting, Accounting and Audit.

(6) It is part of the Goverment. So no legal action can be taken against it without Government permission.

**Merits and Demerits**

The Departmental form of Organisation has the following merits:

(1) There is very effective direct and central control as the accountability of Departmental undertakings to Parliament is complete, their management being under the Ministry concerned.

(2) The civil servants who are Government officials will work sincerly and efficiently for the success of the unit.

(3) There will be less misuse of finance as it is strictly budgeted, accounted and audited by Government.

(4) All the earnings and up to the Government finances. So the tax burden on the people can be reduced. The Government can spend more for Social Welfare.

But there are many demeritts also. They are

(1) Too much of Centralised Control may rob the unit of flexibility in operations. For business flexibility in operations is most important for success.

(2) The Government official who manages the Department may not have business outlook.

(3) There is too much of procedures and resulting delay in action. This is not good for success in business as quick decision and action are vital for success in business.

(4) Since there is no competition to this business, there may be no economic compulsion to improve efficiency.

(5) Losses suffered will mean additional tax burden to the public as only Tax Revenue can make up such losses.

(6) The affairs of the Department are subject to strict Government control. So the officials may not take independent decisions warranted by circumstances.

(7) Since a Ministry is responsible for full control over the department, there may be no continuity in policy as interests may change in a democracy. Besides policies may be made on political considerations ignoring business considerations. There may be political interference in its working.

**Suitability**

The Departmental form of State Enterprises is suitable under the following circumstances :

(1) to provide a service or make a product under direct Government control. e.g., Railways in India.

(2) to maintain complete secrecy in national interest. e.g., Defence Industries.

**Pubic Corporation**

A Public Corporation is an autonomous body corporate specially created by an Act passed by the State or Central Legislature. The powers, duties and responsibilities of the Corporation are clearly laid down in the Special Act. A Public Corporation combines public ownership, public accountability and business management for public ends. It is an organisation clothed with the power of the Government and possessed of the flexibility of private enterprise.

An example of a Public Corporaion is the Life Insurance Corporation of India, created by the Life Insurance Corporation Act, 1956.

**Features**

(1) A Public Corporation is established by a separate Act passed by the Government (State or Central).

(2) It has perpetual existence and common seal. It can act in its own name, hold property, can sue and be sued.

(3) Its capital is fully provided by the Government. It can borrow additional funds from the Government and also from the public.

(4) It is managed by a Board of Directors. The members of the Board are nominated by the Government on the basis of their skill and experience. These may be officials or non-officials or both.

(5) Its employees are not Government servants. Their conditions of service are fixed by the Public Corporation.

(6) The Government will not interfere in the day-to-day management of the Corporation. The Ministry, named in the Act as responsible for the Corporation, will lay down only the broad policies. So there is no political interference.

(7) The Public Corporation has freedom of action in financial management. It is not subject to rigid Government budgeting, accounting and audit controls. It can use its money for purposes decided by its Board of Directors.

(8) The powers, duties and responsibilities of Public Corporation are fixed by the particular Act establishing it. Its relations with the Government, i.e., a particular Ministry are also clearly mentioned in this Act.

(9) The aim of the Public Corporation is primarily public service. So it must use its surplus (profits) to benefit the public e.g., by price reduction or by better service.

(10) A Public Corporation is accountable to the Legislature which created it and also to the particular Minister mentioned in the Special Act. Its accounts are audited by the Comptroller and Auditor-General and the Annual Report is presented to the Parliament or Legislature.

(11) A Public Corporation is required to be run on commercial principles although profit is not the sole aim.

## EVALUATION

**Merits**

A Public Corporation enjoys the following advantages:

(1) It can manage its affairs with flexibility and initiative to suit business needs. It is free from political interference, Governmental delay, slow procedures, etc. Prompt action can be taken in any matter.

(2) The evils of private business like exploiting the public, aiming at profits only and speculating on share values are completely absent.

(3) The Parliamentary and Ministerial control over the broad policies and overall working of the Corporation will protect public welfare.

(4) The Public Corporation gets share capital fully from Government. It can borrow money from the public very easily at cheaper interest. So cost of financing is lower.

(5) It can act as a model employer providing maximum welfare to its workers. So labour unrest can be avoided or reduced.

(6) The Public Corporation will be managed by a Board of Directors consisting of experienced persons (official and non-official) representing various sections of Society. So the interests of all sections of the people will be safeguarded.

(7) The Public Corporation enjoys the benefits of both Government Departmental Organisation and the Joint Stock Company form of organisation.

**Demerits**

But the actual working of Public Corporations has revealed the following defects:

(1) In actual running of the Corporations, there is much interference from Government officers, Ministers and politicians.

(2) In many cases, the managements of such Corporations have misused their freedom of action and gone beyond their powers. This has affected public welfare.

(3) Public Corporation has generally no competitor. So it tends to become inefficient. These losses have to fall on the public, as Government has to give subsidies to make up such losses.

(4) The powers and functions of the Corporation cannot be changed without changing the Special Statute, which may be difficult.

**Government Company**

**Definition:** "A Government Company" is defined in Section 617 of the Indian Companies Act as follows. "Government Company means any company in which not less than 51% of the Paid-up Share Capital is held by the Central Government or by any State Government or Governments or partly by Central Government and partly by one or more of the State Governments and includes a Company which is, a subsidiary of a Government Company as thus defined"

So a Government Company is any Joint Stock Company in which the majority of shares are held by the Government. It is controlled by the Government. The Indian Companies' Act applies to such Companies also. Indian Telephone Industries, and Pallavan Transport Corporation etc., are Government Companies. In India the Government Company is the most common form of organisation of Public Enterprises.

**Features of a Government Company**

(1) It can be easily created. Its powers and functions can be easily modified,

(2) Most of the Share Capital is held by the Government (Central or State or both). But some shares may be given to individuals to make up the minimum membership.

(3) The management is done by a Board of Directors. The members of this Board are nominated by the Government which holds the majority of the shares. But Government usually gives representation to different interests like labour, foreign collaborators, technical experts, consumers, etc.

(4) It has full freedom of action in financial and administrative matters. A Government Company is ordinarily not considered as a servant or agent of the Government.

(5) The Government Company is under the overall control and supervision of the Minister under whose Ministry it is attached.

(6) The Auditor of a Government Company is always appointed by the Central Government.

**Government Company—an Assessment**

A Government Company, as a form of organisation of State Enterprise, has the following **advantages:**

(1) It enjoys a large measure of freedom in matters of finance, administration and personnel.

(2) Flexibility in operations within the provisions of the Companies Act is provided. If any provision in the Companies Act is considered an obstacle for the success of the Company, the Central Government by proper Gazette Notification, can give exemption to the Company.

(3) There is no interference from Government in its affairs. So the Government Company can work just like any private-

owned company. Commercial basis, freedom of operation, quickness of action and greater flexbiility are enjoyed.

(4) Government Company provides for a proper blend of the technical skill, managerial ability and expertise of the private enterprise through collaboration arrangement. For example, the Government can get the co-operation and participation of a foreign manufacturer to make his products in India for sale to our public.

(5) It will try to achieve efficient managerial success as its performanee will be compared by Parliament with the efficiency of similar successful private enterprise units.

But there are certain **demerits** in Government Company type also; they are:

(1) The freedom of operation of a Government Company is absent in actual practice. Since Government is the majority shareholder, the Government is able to impose its will on the management of such Company.

(2) The Government Company suffers from the possibility of interference by politicians and Government Officials.

(3) The officials who are appointed to top positions in the Company may not be dedicated to the success of the Company as they are frequently transferred. Besides they have not contributed any share capital. So they may not work with maximum efficiency.

(4) The Annual Audit Report placed before Parliament tends to reveal mostly financial matters. Not much is said about the operational efficiency, administration, personnel, etc., of such Companies.

**Public Sector Units in Tamilnadu**

In Tamilnadu, there are many Public Enterprise units owned and managed by the Tamilnadu Government and also

jointly owned with the Central Government. Almost all these units are Government Companies.

e.g., Cholan Roadways Corporation;

Tamilnadu Small Industries Corporation (TANSI) etc.,

The Tamilnadu Agro Industries Corporation is jointly owned with the Central Government.

As on 31-3-1977, there were 42 State Public Sector Enterprises working in Tamilnadu. All of them, except the Tamilnadu Warehousing Corporation, were registered under the Indain Companies Act. The Tamilnadu Warehousing Corporation is a Public Corporation.

## QUESTIONS

### Section A—Objective Type

**I. Fill in the blanks in the following questions with suitable word or words :**

(1) An enterprise owned and controlled by the Government is called———.

(State Enterprise or Public Enterprise)

(2) When the Government takes over an existing private concern, it is known as———

(Nationalisation)

(3) The Primary aim of State Enterprises is Public———

(Service or Welfare)

(4) When 51% or more of the shares of a Company are held by the Government, it is called———.

(Government Company)

(5) The oldest form of Public Enterprise is———.

(Departmental Organisation)

**II. State whether the following statements are True or False:**

(6) Departmental form of organisation seems to be the best for any Public Enterprise.

(False)

(7) A Public Corporation can do business without any Government control.

(False)

(8) Private Individuals can also take shares in a Government Company.

(True)

(9) In India, the Goverment Company is the most common form of organisation of Public Enterprises.

(True)

(10) A Public Corporation is clothed with public accountability and flexibility of private enterprise.

(True)

**III. Indicate the correct answer by encircling the alphabet a, b, or c as the case may be :**

(11) The most suitable form of organisation for operating Defence Industries is

(a) Government Company.
(b) Public Corporation.
(c) Departmental Organisation. (c)

(12) In a Public Corporation, the management has

(a) unrestricted freedom of operation
(b) no freedem of action
(c) broadly controlled freedom of action. (c)

(13) In a Government Company the share capital of the Government must not be less than

(a) 75% (b) 51% (b) 90% (b)

(14) For the most efficient working of Public Enterprise, the form of organisation generally considered suitable is

(a) Departmental Organisation
(b) Government Company
(c) Public Corporation. (c)

(15) A Public Corporation is established under

(a) Order of the President or Governor of a State
(b) Indian Companies Act
(c) Special Statute of Central or State Government

**IV. Match the items in List - A with those in List-B**

| List A | | List B | |
|---|---|---|---|
| (16) | *Government take-over of an existing private industry.* | (a) | L.I.C. of India |
| (17) | Pallavan Transport Corporation | (b) | Departmental Organisation |
| (18) | Public Corporation | (c) | Aim of Public Enterprises |
| (19) | State Control over the economy | (d) | Nationalisation |
| (20) | Post and Telegraphs | (e) | Profit maximisation |
| | | (f) | Government Company |

***MATCH PANEL***

| List A | | List B |
|---|---|---|
| 16 | — | d |
| 17 | — | f |
| 18 | — | a |
| 19 | — | c |
| 20 | — | b |

**V. Section B—Short Essay Questions**

(One page answer)

(21) Explain the objectives of Public Enterprise.

(22) Explain the features of Public Corporation.

(23) What are the features of the **Departmental** ***form of*** Public Sector business.

(24) Why do Governments enter business ?

(25) *Explain the features of a Government* ***Company.***

## VI. Section C—Essay Questions

(Three Pages answer)

(26) Discuss the features, benefits and demerits of a Public Corporation.

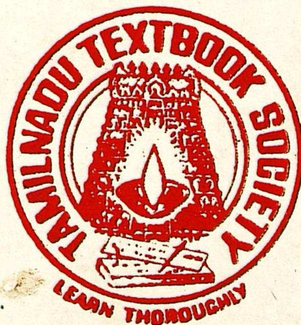
(27) Explain the features, merits and demerits of the Government Company form of organisation.

(28) Explain the features, advantages and disadvantages of Departmental form of the organisation of Public Enterprises.

(29) Discuss the objective of Public Sector Business in a developing Country.

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